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VOLUME I

TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1961

No. 187

CALIFORNIA, PETITIONER,

vs.

FEDERAL POWER COMMISSION, ET AL.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

PETITION FOR CERTIORARI FILED JUNE 28, 1961
CERTIORARI GRANTED OCTOBER 9, 1961

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IN THE

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 15,687

PEOPLE OF THE STATE OF CALIFORNIA, *Petitioner*

v.

FEDERAL POWER COMMISSION, *Respondent*

EL PASO NATURAL GAS COMPANY, *Intervenor*

On Petition to Review an Order of the Federal Power Commission

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JOINT APPENDIX

Volume I

(R. Page 24 to R. Page 2820)

(App. Page 1 to App. Page 562)

EXCERPTS FROM TRANSCRIPT OF PROCEEDINGS

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Presiding Examiner:

. . . . . .

Now, Mr. Shannon, I would like to hear something from you in the nature of a short opening statement. I would like it without argument, but merely state what your position is generally.

Opening Statement on Behalf of El Paso Natural Gas Company by Charles V. Shannon

Mr. Shannon: Well, Mr. Examiner, as you indicated at the outset of the hearing, El Paso is seeking authority under Section 7 (c) of the Natural Gas Act as amended to acquire and operate the facilities of Pacific Northwest, constituting its pipeline system as it now exists, as it may be enlarged or

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extended prior to the date of proposed acquisition, including the right to complete and operate any additions that may be certificated prior to that date.

El Paso now owns in excess of 99 per cent of the outstanding common stock of Pacific. El Paso will advance the sum $23 million to Pacific with which Pacific will retire its outstanding preferred stock. The merger will then be accomplished pursuant to the provisions of the Delaware statute, and El Paso will cancel the stock of Pacific and assume Pacific's corporate debts and liabilities.

We propose to present a complete showing here which will cover all phases of this merger and will show the reasons why we believe the merger is in the public interest and should be authorized by the Commission.

Our first witness will be Mr. Paul Kayser, the President of El Paso, who will cover the entire matter; and Mr. Silloway of Pacific will be next; Mr. Hugh Steen, Vice-

President in Charge of Operations of El Paso, which will cover the savings and the operating flexibility and other advantages of the merger; Mr. Arnold LaForce will cover the financial phases of the merger—he is Vice-President of El Paso, in charge of finance; Mr. Emory Katzenbach, who will testify with respect to the financial aspects of the merger. And we will also present the detail that is required by the regulations under the certification section.

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I would like to point out, Mr. Examiner, that as I see this case, while we have to present all of the more or less boiler plate exhibits that are required by the regulations, our plan is to cover the real issues, and that is, the issues opposed by the merger first, through Mr. Kayser's testimony, and the testimony of the other witnesses I have named. And after we have done that, we will put on Mr. Holik, Mr. Norwood, Mr. Dunn and Mr. Hill, and we will present the normal economic market geological and other data that is called for by the regulations.

As I see the case, the issues posed are primarily policy questions for the Examiner and the Commission, and we intend to approach the case from that standpoint first and then make a complete record as required by the regulations.

Presiding Examiner: Thank you, Mr. Shannon.

Mr. Payne, do you have anything to say, sir?

Mr. Payne: Mr. Examiner, as the Examiner knows, Pacific Northwest Pipeline Corporation is a natural gas company within the meaning of the Natural Gas Act and is subject to the jurisdiction of this Commission. It is engaged in the production, purchase, transportation and sale in interstate commerce of natural gas.

Pursuant to authorizations of this Commission, principally in Docket Nos. 1429 and 8923, et al, Pacific has

constructed, owned and operates about 2,125 miles of main and lateral pipe-

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lines extending from its own reserves in the San Juan Basin area of New Mexico through the States of Colorado, Utah, Wyoming, Idaho, Oregon and Washington to a terminus at the international border between the United States and Canada. Pacific sells gas to other pipelines in Wyoming, and its principal distribution and direct industrial customers are along the route of its line in Idaho, Oregon and Washington. Pacific is authorized to, and is, importing from Canada natural gas under a contract with West Coast Transmission Corporation calling for the sale of up to 300 million cubic feet of gas per day.

Over 99.8 per cent of the common stock of Pacific is owned by El Paso Natural Gas Company, which proposes in these proceedings to acquire the assets of Pacific by means of a statutory merger. The applications in Docket 13018 are interdependent with those in 13019, and Pacific is seeking authorization to abandon the facilities and the appurtenances constituting its pipeline system, to abandon the service rendered by means thereof in favor of the acquisition and operation of those facilities by El Paso as requested in El Paso's application at Docket No. 13019, Pacific's request being conditioned upon the granting of El Paso's application and the confirmation of the merger as proposed in those Dockets.

Pacific will present nine witnesses, as stated by Mr.

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Shannon. Mr. Silloway will cover policy and public interest aspects of the merger. After the El Paso technical witnesses, who have been listed by Mr. Shannon, Pacific will present the technical phases as required by the regulations of the Commission. It is our feeling, as stated by Mr.

Shannon, that the presentation is explanatory as to those facilities, the purpose being to put in the record the nature of these facilities and the facts of the operation. We are not seeking authorization here for new services, and it differs in that respect from an ordinary certificate case.

We will have, as I said, nine witnesses in all. Mr. Hiatt will cover the corporate documents, gas purchase and supply, contracts and certificates and related authorizations. Mr. McBride will cover engineering, design and flow charge, the description of the facilities to be abandoned, including those constructed and those which have not been completed, and certain of the cost figures. Mr. Copp will cover the markets and a portion of the revenues. Mr. Allyne will testify concerning costs of operation and the facilities map.

Mr. Truby will support certain production costs and gas requirements figures. Mr. Owens will cover the accounting phases and cost of facilities.

Mr. Cramer will support the financial exhibits, and Mr. Art Hill of El Paso will present Pacific's gas reserves and deliverability evidence.

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Presiding Examiner: Thank you, gentlemen, both of you. It has been very helpful to understand, get a better understanding, from your opening statements of what the issues before me may be.

Does anyone other than the applicants desire at this time to make any statements other than already made, particularly concerning the issues or their position to be taken in the case?

Yes, sir.

Mr. Bennett: Mr. Examiner, I wish to make this statement on behalf of the Attorney General of the State of California in representation of the State of California and of the people and gas consumers thereof.

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It is the opinion of the State of California that the acquisition and operation of the facilities of the Pacific Northwest Pipeline Corporation by the El Paso Natural Gas Company is not in the public interest.

The interest of California in this hearing is a real and perhaps unique one because of its special position as the dominant customer of El Paso. Our state is dependent upon natural gas supplies for the maintenance of industrial and domestic needs. More importantly, the growth of California has increased our need for natural gas.

It is our position, on behalf of California consumers, that this vital commodity is best supplied in a possible future

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competitive setting. We feel that neither our distributing utilities, nor our ultimate consumers, should beholden to but one supplier. It is our position that absent the benefits of the competition factor, El Paso is in an unduly advantageous bargaining position with reference to California so far as price ar availability of natural gas are concerned.

The State California asks this Commission to weigh this Commission to weigh this case with the theory and philosophy underlying the express policy of the Congress and the electorate relating to monopoly situations as expressed in the laws pertaining thereto. We point out to the Examiner and to this Commission that the issues here involved have been made the subject of a complaint by the Department of Justice of the United States of America in the United States District Court of the District of Utah, wherein there is to be litigated the question of whether the acquisition by El Paso Natural Gas Company of the common stock of Pacific Northwest Pipeline Corporation is in violation of the Clayton Act.

In brief, California has no wish to be made solely dependent for a commodity so vital as this upon a single sup-

plier. It is our position that industry and consumers alike benefit mutually from operations conducted within the free enterprise system of which the dominant characteristic is said to be healthy competition.

California is not served, with reference to other vital

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services in the field of transportation, banking, or whatever, by a single corporation. We have no wish to depart from that situation simply because the commodity we are now seeking is natural gas.

It is our position that the application before this Commission and the relief therein requested is contrary to the interest of the West, and particularly to the interest of the State of California. We ask that this merger be rejected as being against the public convenience and necessity.

Thank you.

Presiding Examiner: Well thank you for your comprehensive statement, which will be treated, of course, merely as a pleading of your position.

Mr. Bennett: Yes, sir.

Presiding Examiner: Making of an issue through the statement of your position, and that makes it helpful.

Mr. Shannon: Mr. Examiner, I know that Your Honor would not like any argument at this point from me, but I would just like to state I am sure when we have presented our showing here that the misgivings of the Attorney General of California will be met and he, along with the others, will favor this merger.

Mr. Bennett: Mr. Examiner, now that I have departed from the text, let me say without qualification that I am certain that no matter what is developed here by the corporate

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applicants, our position will not be changed in the leastwise. We have definite notions about this merger. We are

(982)

representing 12 million people here, and we think for our people in California that this thing is not good, it is not healthy, and we reject it, and we ask the Commission reject it.

Presiding Examiner: Well that gives us a clear-cut issue to try here. That is what these tribunals set up by the Government are for, to try just such issues.

. . . . . .

Presiding Examiner: Does the Staff wish to make any statement at this time, Mr. Kurtz?

Mr. Kurtz: We have no position at this time, Mr. Examiner, because we do not know what the evidence is going to be.

. . . . . .

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Paul Kayser

. . . . . .

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Direct Examination

By Mr. Shannon:

Q. Please state your name, address, and occupation. A. My name is Paul Kayser.

I live at Houston, Texas. I am President of El Paso Natural Gas Company and also President and Chairman of the Board of Pacific Northwest Pipeline Corporation.

Q. Mr. Kayser, would you please summarize your business experience including your work with El Paso? A. I practiced law in Houston from 1913 to 1928.

At that time, with my associates, I organized the El Paso Natural Gas Company and was its first President and have been its President since that time.

My experience with the company has been in the negotiation of contracts. I negotiated practically all of the im-

portant contracts myself up to a few years ago, both for the purchase of gas and the sale of gas. I have also kept in close touch with the negotiations in all events. Until a few years ago, I negotiated all of the financing contracts of the company and, of course, in the last three or four years they have been handled by Mr. Arnold La Force, but I have kept in close touch with the negotiations and with the decisions that had to be made.

As to my other activities, I was one of the organizers of the Independent Natural Gas Association, was President of it

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in 1951, 1952. I am a director of the American Gas Association, American Petroleum Institute, and a member of the National Petroleum Council.

Q. Mr. Kayser, have you previously testified before this Commission? A. Yes, sir; I have testified off and on since the Commission was first organized in 1938, I believe it was, and I have testfiied in all of the important proceedings of the company before the Federal Power Commission.

Q. Please briefly describe the proposal for which El Paso is seeking Commission approval in this proceeding. A. As was stated by counsel in the beginning, the El Paso company is seeking under Section 7(c) to acquire by merger all of the properties, rights, and so forth, of the Pacific Northwest Pipeline Corporation, both what is now certificated, all of the rights to its properties, all of its properties and all of its rights, and it assumes, of course, at that time all of the obligations of the Pacific Northwest.

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Q. Mr. Kayser, do you have a copy of Exhibit Number 1 for identification before you? A. Yes, sir; I have.

Q. Was this map prepared under your supervision and direction? A. Yes, sir; it was.

Q. I would like for you briefly to state for the record what you have undertaken to show on this map. A. What the map undertakes to show and does show in the United States are the relevant portions, west Texas, parts of Oklahoma and parts of Kansas, all of New Mexico, Arizona, California, Nevada, Utah, Colorado, Wyoming, Idaho, Oregon, Washington, and some parts of Montana, as well as the Provinces of British Columbia in Canada and Alberta, Canada.

Those are the relevant portions of the map geographically.

Shown on this map and the purpose of introducing the map is to show the lines of the El Paso system. They are shown at the bottom of the map and, generally speaking, they run from—going on the western side, the map shows the sources of supply in the States of Texas, New Mexico, Oklahoma, and Kansas, from which the El Paso lines draw their supply, and it shows

those lines to the market areas in west Texas, New Mexico, Arizona, and California, showing the multiple lines that lead into the delivery points in California, near Blythe on the Colorado River, and near Topack also on the Colorado River.

The map also shows the lines of the Pacific Northwest which generally can be described on the map as shown on the map, starting out of the San Juan Basin of the northern edge of it, going northwestwardly through the States of Colorado, Utah, Wyoming, Idaho, Oregon, and Washington, to the Canadian Border, a little place called Sumas, and up to Spokane on the extreme right of the map, the northern portion of the map, upper portion of the map.

It also shows the West Coast Transmission system as now constructed beginning at the little point called Sumas on the Canadian-American Border and extending on upward to the Peace River area in British Columbia, the gas fields which are the source of supply.

The map also shows the California coastlines, southern California coastlines, generally running out of Blythe to Los Angeles, except there is another line running out of Topach over to the Los Angeles area, and the Pacific Gas and Electric Company lines running from Topack on up to San Francisco.

They are delineated on the map in black.

Also shown on the map are the other lines leading—in fact, all the other lines in the area, particularly those

leading out of the Hugoton Field other than the ones that we have.

There is also shown on the map in a dotted line the proposed line of the Trans-Western Gas Company, a line that is proposed from the Permian Basin fields shown at the extreme southeastern corner of the map, shown in a dark, shaded portion, and from the west Texas fields, west Texas Panhandle fields, likewise shown in a shaded portion in extreme northwest Texas, joining up near the little town of Roswell and proposed to go clear over to Topack.

This has been filed with the Federal Power Commission and is now in process of being developed.

The map, likewise, shows in a dotted line from San Francisco up to a point on the map, on the Canadian Border, near the little town of Kingsgate, the proposed line of the Pacific Gas & Electric Company from the Canadian sources of gas in Alberta to the San Francisco-Oakland Bay area.

Application for this line has not been filed yet with the Federal Power Commission, but applications have been filed before the Canadian authorities and the Pacific Gas &

Electric Company has testified to their plans, which necessarily include the line shown on the map as being the Pacific Gas & Electric Company's project.

Also shown in a dotted line is the proposed line of the Pacific Northwest to join to a proposed line by West Coast

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Transmission to take 150 million feet of gas from Alberta. This line is shown on the map as a dotted line, likewise, through the Kingsgate gateway.

West Coast Transmission has filed their application with the Canadian authorities and it has been heard by two of those authorities just like the Pacific Gas & Electric Company's proposition has been heard.

Q. What is the principal business of El Paso, Mr. Kayser? A. The principal business of El Paso is the ownership, and operation, of natural gas pipelines. It is a natural gas company under the Natural Gas Act, and has constructed and has in operation approximately eight thousand miles of main transmission lines.

It is likewise engaged in the production and acquisition by purchase of natural gas. Its operations have been principally in the Permian Basin area and the Panhandle area of west Texas and in the San Juan area of New Mexico, also shown on the map.

It carries on extensive exploration campaigns to discover gas and to augment its reserves over the entire area through which it operates. It delivers gas at wholesale, generally speaking, to the city gates of the various communities that it serves. It has a small amount of direct sales but they are comparatively unimportant at present. It sells large quantities of gas, of course, at the California Border to the

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California companies. It sells gas throughout the entire area that it transverses on the way to those markets. It

sells something like a billion, thirty million feet of gas a day to the Southern companies and about a billion, twenty-five million to the Pacific Gas & Electric.

Q. Will you briefly summarize the history of El Paso's system? A. Well, it was organized in 1928 for the purpose of constructing a 16-inch pipeline, about 200 miles, to El Paso, and it was expanded up until 1945 into a comparatively small company, some thirty-odd million dollars, but after 1945 with the great expansion that occurred throughout the entire country and particularly in the natural gas business, it expanded its lines to California and to the other areas not then served in New Mexico.

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Q. What, briefly, is the business of Pacific Northwest? A. Pacific Northwest, as stated in the Opening Statement of Mr. Payne, operates a pipeline of some 2,100 miles in length,

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lateral lines, from a point in the San Juan Basin as shown on the map, in a northwesterly direction through the States of Colorado, Utah, Wyoming, Idaho, Oregon, and Washington, to a terminus on the Canadian Border.

It obtains its gas supply in the San Juan Basin and in the States of Utah, Colorado, and Wyoming. It has a contract with West Coast Transmission for the delivery at the border at Sumas of 300 million a day, two hundred million a day of which is being delivered now and the balance will be delivered beginning next year.

Q. Do you recall, Mr. Kayser, when Pacific Northwest was first granted a certificate by the Commission? A. I believe that was on June 18, 1954.

Q. And did that include the importation of any gas from Canada? A. Yes, it did.

Q. The original? A. No, the original did not. The actual final certificate issued under which it was built did.

Q. Now, following the issuance of the initial certificate which did not include any importation of gas from Canada, did El Paso enter into any contractual arrangements with Pacific Northwest and West Coast Transmission with respect to the importation of gas from Canada? A. Yes. In December, 1954, El Paso entered into two

important contracts with Pacific Northwest. This was prior to the importation of gas from Canada and shortly after the granting of the original certificate.

The first and most important of these contracts dealt with the importation of Canadian gas. El Paso agreed to purchase from Pacific Northwest 250 million cubic feet of gas to be delivered to El Paso at a point in Idaho, a little point called Mountain Home, shown at Station Number 11 on the map, in Idaho.

At the same time, Pacific Northwest entered into a contract with West Coast Transmission to purchase 300 million cubic feet of gas to be delivered to it at the Canadian Border near Sumas.

Also at that same time, El Paso entered into a comprehensive contract for the exchange of gas between the companies in the San Juan Basin, beginning with 100 million per day to be furnished to Pacific Northwest for three years and tapering off for two more years.

This contract likewise called for cooperation between the companies in the drilling of wells, gathering of gas to bring about an orderly and economic development of the acreage owned by each in the San Juan Basin.

These contracts were all dated December 11, 1954.

I would like to state that the purpose of this contract, these contracts, was to make available to the markets of

El Paso 250 million feet of Canadian gas. That was the sole purpose of

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them and it likewise was the motivating force as to why we executed the exchange contract making available to Pacific Northwest 100 million a day out of San Juan for short periods.

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Q. Mr. Kayser, did El Paso in the subsequent years enter into additional contractual arrangements with Pacific Northwest? A. Yes, sir; we applied for a certificate to the Federal Power Commission to build a line from Mountain Home down to the California Border. It became apparent after we had pursued that rather vigorously for some time that it was not going to be possible to accomplish that purpose; and, in August, 1955,

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when it did become apparent that we couldn't accomplish it, we entered into a contract with Pacific Northwest under which we modified the contract of December 11, calling for the purchase of 250 million cubic feet of gas per day delivered at Mountain Home; so that we took 50 million firm delivered to us on an exchange basis at Ignacio and gave to Pacific Northwest the right to put to us—that is, require us to take another 50 million feet at that point.

This contract superseded the old contract of December 11 involving the delivery of 250 million per day at Mountain Home. It enabled Pacific Northwest, then, notwithstanding the failure of the so-called "Mountain Home Project" to make firm their contract with West Coast Transmission for the purchase of 300 million cubic feet per day to be delivered at Sumas on the International Border.

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Now, on the basis of these contracts, the Federal Power Commission in November, 1955, authorized the importation of the 300 million cubic feet of gas a day in accordance with the contract, and the Canadian authorities likewise made definite their authorization of the export of this amount of gas to the American markets.

These contracts were the basis of the financing of West Coast Transmission and the construction of the 650-mile pipeline from the Peace River area shown at the extreme northern top of the map to nearly all the way up across the Province of

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British Columbia, to the little town of Sumas on the American-Canadian Border.

The total cost of this project was something in excess of $200 million. It is a 30-inch pipeline and capable of delivery of approximately—in excess of six hundred million a day. It serves not only the contract with Pacific Northwest but Vancouver and the other market areas in Canada, and I would like to say that this pipeline could not have been built except for the amount that was agreed to be taken into the American markets.

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Q. Mr. Kayser, did you thereafter—that is, El Paso —thereafter enter into any agreement with Pacific Northwest with respect to the gathering of gas in the San Juan Field?

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A. Yes. We entered into a gathering contract. It was de gned for the purpose of avoiding unnecessary duplication of gathering facilities in the fields. It was apparent that there would be expenses and unnecessary duplication

if each company built an entirely separate gathering system.

For instance, Pacific Northwest had certain wells on leases under contract on, we will say, the western side of the field and its principal gathering system and main gathering lines were on the northern side of the field. Obviously, to build clear across this field, which is some 40 to 50 miles wide, was wholly uneconomic.

Likewise, El Paso had some leases on the eastern side of the field that could better be served by putting the gas into Pacific Northwest's gathering system. So we entered into a contract agreeing out the cost, the price that we would perform, each would perform the gathering system for the other, and entered into a contract calling for the exchange of such gas between them for a gathering service.

Q. Now, did all of these contracts which you have enumerated precede any acquisition by El Paso of the stock of Pacific Northwest? A. Yes, they did. But they also illustrate the fact that savings could be made and that by cooperation in the field it would be possible to render more efficient service.

Q. Now, did El Paso conclude that it was advisable for

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El Paso to acquire Pacific Northwest? A. Yes, it did.

Q. Will you state the reasons. A. The principal reason, one of the principal reasons was that, as you can see from this map, Pacific Northwest represented a direct connection to the potential reserves of Canada. These reserves are among the largest on the North American continent. Certainly the largest remaining reserves from which no great amount of gas has yet been taken.

The shaded portions on the map in Alberta represent the fields that have to date been discovered. These are but a small part of the area that is still prospective, and it is generally understood in the area that—I mean, that

in the industry—that the potential of Alberta and British Columbia are among the greatest, in fact, are the greatest yet undeveloped reserves on the continent.

It was apparent to us that by acquiring Pacific Northwest, we would have access to these reserves. It was also apparent that we had already learned that one system complemented the other. The Pacific Northwest ran up through the Rocky Mountain region while the El Paso system went to the south and east into the reserve areas of the Permian Basin, West Texas, and the Hugoton Fields of Kansas, both of them having only the one common field, and that was San Juan.

Now, the next potential reserve area in the United States—

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by potential reserve I mean areas where the gas had not been developed as fully as it has in the other areas of the United States, and that is the Rocky Mountain area. There are good reasons for this.

One, it is furtherest away from big markets, and two, it is the roughest country in the world to operate in. Consequently, the oil industry and the gas industry have not prospected in that area as much as they have in the balance of the United States.

Pacific Northwest line leads right up through the prospective area, and consequently furnishes for El Paso an access to those potential reserves. From the standpoint of Pacific Northwest, also Pacific Northwest needed additional markets for their gas, and the putting of these two together as a joint enterprise gave the opportunity to set up a system that, as we regarded it, could most efficiently and effectively and for the longest length of time serve the great markets of the Pacific Coast.

Q. Mr. Kayser, after reaching the conclusion that El Paso should acquire the Pacific Northwest, what did you

do? A. Well, we talked to the financial people as we usually advise with, the executives of the banks with whom we do business, and with the insurance companies to whom we have sold bonds of a long period, and asked them as to what they thought of the advisability of such a system, and they were

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uniformly enthusiastic about it. In addition, we consulted the firm of Sullivan and Cromwell and asked them for an opinion as to whether or not the acquisition of this pipeline would be in violation of the antitrust laws.

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A. We actively entered into negotiations with Pacific Northwest directors and principal stockholders for an exchange of stock, of El Paso stock for Pacific Northwest stock with a view to acquiring the stock of Pacific Northwest. This was done in November 1956, and pursuant to this contract, the offer was made to the stockholders of Pacific Northwest after due authorization by the Board of Directors of the El Paso Company, and the offer was made on January 8, 1957, and accepted to the point where before the offer was entirely closed, El Paso had acquired 99.8 per cent of the stock,

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outstanding stock of Pacific Northwest.

Q. Mr. Kayser, why did you not negotiate a contract at that time covering the acquisition of the assets of Pacific Northwest? A. We attempted to negotiate such a contract from the inception of the plan to acquire Pacific Northwest, and El Paso would much have preferred to have consummated the acquistion by acquisition of the properties rather than the stock. But the officials of Pacific

Northwest were adamant and unwilling to make that kind of a trade, for it seemed to me very good reasons. They were in the midst of financing their construction. They were in the midst of financing the portion of the construction involved in bringing gas from Canada. They were in the midst of constructing the portion, a portion of the pipeline, and to go the acquisition of properties route would have required long hearings, as is apparent at this time, and delay that could not be endured by the Pacific Northwest Corporation.

It was necessary for it to continue its activities because it did not know until the end of the merger proceeding whether it was to continue as a separate corporation or whether it was to be merged into El Paso. Consequently, during that period Pacific Northwest would be in the position where it would not be practicable to sell any of its securities and it would be extremely difficult to build up its organization

because no one would know whether or not the corporation was going to continue. It simply was not practicable to make the application on that basis.

From El Paso's standpoint it was not possible to do it because the officers of Pacific Northwest were unwilling to negotiate on that basis.

Q. Now, when was the decision reached—

Mr. Kurtz: May I interrupt right there?

Mr. Kayser, before we pass this subject, you referred to officials of Pacific. Could you be a little more specific and give us their names?

A. Mr. Silloway, who will testify, was President at that time and he was the principal officer who stated the company's position to me.

Mr. Kurtz: And did you have conversations with Mr. Fish also on the subject?

The Witness: Yes. He was a large stockholder and—yes, I certainly did. I had conversations with Mr. Fish and with other directors and stockholders on the same point. But Mr. Silloway was in charge of the financing, in fact, the operation, and he was the principal spokesman.

Mr. Kurtz: Thank you.

By Mr. Shannon:

Q. Mr. Kayser, when was the decision reached to acquire the facilities of Pacific Northwest by merger?

[redacted]

A. In the initial acquisition we handled the matter as a separate corporation, made our plans on that basis, and set it up on that basis because that was the only one that we could—the only way we could acquire the stock.

However, early in the operation of the properties as a subsidiary, it became apparent that you could more efficiently operate them if we could integrate them together. There were so many points of contact that it became apparent to us that it would be more—that we could more efficiently operate the properties by putting them together.

[redacted]

Q. Mr. Kayser, I would like for you to state now some of the advantages, as you see them, which the consuming public will obtain from the proposed unification. And first I would like you to discuss the matter of gas reserves.

A. Well, I think it is axiomatic that every customer of a pipeline system is greatly interest in the extent of the reserves that may be reached by that system, and to our notion every single customer of El Paso and every customer of Pacific will receive an advantage from the merger in respect to the supply situation.

To me the merger presents the strongest part of its appeal in the fact that the merged system will have access to all fields that have presently developed reserves and all

potential areas that are within economic reach of the market.

Now, you look at the map and you see, of course, that the El Paso system is connected with many lines into the Permian Basin. You see it is likewise connected to west Texas and the Hugoton area in Oklahoma and Kansas. You see that both systems are connected into the San Juan area. Then you see that Pacific Northwest runs right on up to the west through the—adjacent to the proven areas and through the entire potential area of the Rocky Mountain region.

In addition, it connects on up at Sumas with the West Coast transmission which, in turn, is a 30-inch line taking gas out of Peace River area in British Columbia, an area that was dis-

covered less than five years ago, I believe, but from which no gas whatsoever had been taken prior to the building of the West Coast transmission line.

Now, then, in addition to that, the plan is to connect into the Alberta reserves so a pipeline connecting to the Pacific Northwest at Kingsgate, again connecting with West Coast transmission which in turn has contracts in their Savannah Creek field and other fields for 150 million feet of gas. And those fields likewise are the fields of the greatest potential in Canada.

It is true that some gas has been taken out for local use and the Trans-Canada Pipeline likewise takes its supply from that region and its demands have to be taken into consideration in considering what gas can be made available for the American market.

Now, that to me was the picture that in my judgment represents the greatest advantage to all of the customers of both companies.

I wish to point this out. The Hugoton field in Kansas, Oklahoma, and a little bit down in west Texas, together with the so-called west Texas field, has pipelines as shown on the map leading to practically all the centers of population and demand. That is one of the very oldest producing areas in the United States. It was discovered, I believe, in 1919, the Hugoton field was, and I think west Texas maybe in 1921 or

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something like that, that there are these multiple lines leading out to Chicago, Detroit, Minneapolis, Kansas City, Omaha, Denver, and other areas from those lines.

They are taking, together with El Paso, what it takes out, approximately four billion feet of gas a day from those fields. Now, those fields are necessarily limited in life with that much withdrawal from them, and they have already produced longer than anything except the fields of Louisiana and the Appalachian region.

When we come to the Permian Basin, it was discovered about 30 years ago but we have been taking gas out of it for 30 years and Northern Natural is taking gas out through the Permian Basin pipeline and Lone Star is likewise taking gas out as, of course, Transwestern is proposing to take a large amount of gas out of that field. But it is 30 years old and it is substantially developed, and in addition to that, it is predominantly an oil field and the gas that we take from it is predominantly residue gas.

When you come to the San Juan Basin, that is a big field, tight formation, but its potential, with the exception of certain strata a little deeper than that that is presently developed in the Mesa Verde, its potential has nearly all been used up in the sense that you can pretty well tell what it is going to do.

The Four Corners area shown on the left there, the Aneth

field is an oil field. It has a lot of gas in connection with it, but the total potential of the area is not too great.

Then, as I have stated before, you run into the potential areas of the Rocky Mountain region and the areas of Canada. So that this great market on the Coast will through this system have access to all of the producing areas that can be brought to that market on an economic basis.

Mr. Kurtz: Wouldn't you say, if I might interrupt, Mr. Kayser, wouldn't you say that the Canadian gas—it is your position, is it not, that it will benefit all customers regardless of where they may be located?

The Witness: Yes. I did say that, Mr. Kurtz, because as we conceive it now, and I expect we are fairly close to right, the great problem in the gas business is going to be length of service.

Now, certainly the aim of all of us should be to lengthen the life of the service to the maximum extent that it can be in relation to the resource that Nature has deposited there for our use.

Now, that is what we are driving at, and we think it is highly important. There are lots of billions of dollars invested in the gas industry. We have got a good many hundreds of millions of dollars invested in a property that has no value when the reserves are gone. And we know, working with these things every day, that every time you come up to look at your reserve picture, if you hadn't

acquired some additional reserves, your picture would deteriorate every time you looked at it and your life would be limited, definitely limited, and you can calculate it in third-grade arithmetic.

Now, somewhere we are going to come to an end of those

reserves, but that is another story entirely. Certainly the provision that all of us should make is for the maximum effort to connect the markets, the responsibility of serving which we have assumed, with the maximum areas of potential production.

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Mr. Kurtz: In other words, what you have with Pacific and El Paso is a completely integrated system.

The Witness: That is exactly what we think. We have an integrated system and we have the advantage of gas at both ends of that system which makes for flexibility beyond any flexibility you can get out of any system that takes its gas from one point and delivers it at another without anything intervening.

Here you have abundant supplies in the southeastern portion of the system, abundant supplies in the extreme northwestern system, and substantial supplies already developed in between with substantial potential for development there.

Now, I would like to say this one further thing. El Paso is already exploring through all of this area for gas to maintain its service. By means of the merger we will be in a much better position to explore through the Rocky Mountain region than we would be otherwise.

Presiding Examiner: In what area is your exploration at the moment? You spoke of it. I just want to make that clear.

The Witness: Yes sir. We are exploring the San Juan Basin. We are exploring in the Permian Basin. That is to the south. We are exploring in West Texas and even over into Oklahoma. Now, in addition, we have an office at Salt Lake and we are carrying on exploration in all of the Rocky Mountain region.

Now, in addition to that, we have quite a bit of exploration in Canada, so that we are anticipating being able to augment our supplies in all of these regions.

Presiding Examiner: That wasn't made clear for the record. That is why I wanted it.

The Witness: Yes sir. That is exactly what we are doing and that we regard as being part of the obligation of undertaking to serve a community.

By Mr. Shannon:

Q. Mr. Kayser, in the course of your testimony you mentioned the matter of residue gas. Would you please state the advantages of the unification as you see it from the standpoint of purchase of residue gas, and in that connection explain the problems that are involved in El Paso's purchase of residue gas.

Presiding Examiner: Giving an explanation of what the residue gas is. We understand it, but for the record, the Court may not. I don't know.

The Witness: Well, I would like to give the definition first.

The term "residue gas" as applied to gas means the gas that is available on the discharge side of a gasoline absorption plant. The gasoline absorption plant operates on this principle. The owner of the plant builds a gathering system to all of the or most of the producing wells, wells producing

oil, in a given field, and gathers what is known as casinghead gas.

Now, that gets its name from—it is too long a story to say why it is called casinghead, but it is gas that comes out of an oil well generally in solution with the oil. Some-

times it is out of solution as it comes on up in the pipe, and it is separated from the oil by a conventional oil field separator and comes off from the top of the oil field separator whereas the oil drops off from the lower side of the separator. That gas called casinghead gas is generally highly saturated with natural gasoline, butane, and propane, those three liquefiable products. It is taken over to the plant and put through an absorber and various cooling systems and so forth, that are involved in it, and the natural gasoline, butane, and propane drop out and the resultant so-called residue gas is what is left after the extraction of those products.

It then is either sent to market or has to be flared at the plant.

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Q. Mr. Kayser, before the noon recess you had described and explained what residue gas is.

Now, would you tell us what problems, if any, the marketing of residue gas involves? A. Yes. The El Paso company in 1957 marketed a billion 300 million feet of residue gas a day. Now, that gas is produced in response to the demands for oil and not the demands for gas. All of the oil production in the Permian Basin, whether it is in New Mexico or in Texas, is geared to—now, I didn't say regulated by, but it is geared to the regulation of the Texas production by the Railroad Commission of Texas.

Now, the Railroad Commission of Texas holds hearings every month in which they have the companies who are marketing the oil out of the Permian Basin nominate their requirements as to how much oil they want to take out. They listen to all of that, have a hearing, and then the Commission fixes an allowable per well that produces enough oil to meet the demand for oil as

arrived at from all of the nominations of the various companies that are going to take oil out of the Permiam Basin.

Now, the mechanics of the regulation are that they issue an order allowing the well to be produced so many days that month. In other words, they say that taking into account the mechanical characteristics of the well and reservoir, the well can produce so much in a day, and then they say it can produce so many days.

Now, that doesn't mean the wells produce—and they set here just recently eight days as the number of days in a month that the well can produce—now, that doesn't mean that the well is produced eight straight days and shut-in. It means that if you multiply the eight times the allowable for that well, you get the total allowable that can be produced by that well that month, and so they run it along various days in the month in order to produce the quantity.

Presiding Examiner: May I interrupt there? Could the period of production of the allowable be extended beyond the eight days but still be in the month?

The Witness: Within the month. It can not be extended beyond the month. It can be extended and is extended throughout most of the days of the month.

All right. Now, the Commission met the next month and, as they do, they said that I believe nine days was the proper allowable. Then they met again the following month and

I believe they said ten, and at any rate now—that was last May—now the allowable is twelve days.

Now, here is the problem with the El Paso Company. Everytime the Texas Railroad Commission puts a day

on or takes a day off, it puts 40 to 50 million cubic feet of gas a day on to the El Paso Company or takes 40 or 50 million cubic feet a day off of the El Paso Company. That is the effect.

Now, that is one effect. Now, the other effect is this, that at the end of the month, because you can't make an allowable up after the end of the month, you must finish it up for sure in that month or the oil companies producing it lose the allowable which is just that much loss, so most of the companies—and there is no criticism of them whatsoever in this statement—most of the companies run on out to the end of the month and a day or two before the end of the month they have completed their allowable and they shut the well in. So this takes a tremendous amount of gas off of our system at the end of the month and makes a very difficult operating problem.

We worked it out in conjunction with the producers and cushion that as much as we can. We get good cooperation.

Now, still another thing. On a cold day they just don't get out so early in the morning and turn the wells on. They don't have to. They have got plenty of time to make up the gas, the oil production, and that is the day we need the gas, and that throws a burden on us. One cold spell last year, I

believe it was, we had to provide 500 million cubic feet of gas a day to take the place of the swing that occurred in residue gas, take the place of the deficiency of residue gas for that day for those cold days. That is when we needed it worse than ever.

So, those are the problems that—the principal problems that arise.

Now, the fundamental of it is that the gas comes with

the oil, dissolved in the oil, and it comes out as the oil comes out, and there is no way—we don't complain about it at all—there is no way to complain about it—there is no way to regulate the flow of the gas and in relation to our demands for the gas. It can only be regulated by the flow of the oil and the demands for oil.

Consequently, we have to be ready to take it when it comes.

Now, in order to do that, we have to build facilities larger in taking the residue gas than we do in taking the dry gas. But in order to able to take so large a proportion of our demands as a billion three, which is plus or minus one-half of our total demand, in order to be able to supply so great a demand, so great an amount of our demand out of the residue, we simply have to have dry gas that we can turn on and off at will to take care of those deficiencies. Consequently we are every day trying to build up the quantities of dry gas

that we have access to and to build into our system excess capacity from those dry gas wells to take care of this variability in residue gas.

Now, in addition to that, the percentage that we are using of residue gas is so high that we are struggling every day to reduce that percentage. It used to be higher than it is now. It used to be as high as 67 per cent. We have got it down now to around plus or minus 50 per cent.

Now, the reason for that is this, to me. When you depend for so large an amount of your supplies on residue, there are two things that happen to you. One is you have got to provide all this excess capacity and you have the uncertainty and the variability of the availability of the supply. The other that hurts every day is that residue

gas can not be estimated reservewise for a period much longer than twelve to fourteen years because oil production is taken out on a basis of fairly well getting out the principal production in a period of twelve years. That is the factor. With the result that the available gas from an oil field, the residue gas available to a company marketing residue gas, has a life close to twelve to fourteen years.

Now, when you have so large a proportion of gas that you are dependent upon as residue gas, you are not able to show as long a life of reserves for your pipeline as you do in the case of that that is relying upon dry gas, with the result that

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El Paso Company has probably—now, I haven't compared this fully but I know it generally—the highest amortization rate on its bonds of nearly any other pipeline in the country of the size of El Paso. Our reserves we are unable to hold, to show them as taking care of all of our demands for over fourteen, fifteen, sixteen years. Our bonds are generally maturing on sixteen to eighteen years. I don't believe we have any bond issue outstanding at this time that runs for a full twenty years.

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Presiding Examiner: May I ask you a question? You have spoken of but two classifications of gas. You have spoken of residue gas and dry gas.

The Witness: Right.

Presiding Examiner: Now, for the record, when you speak of dry gas, you mean gas not produced with oil?

The Witness: That is right. Not associated with it.

Presiding Examiner: Because the term is used in the industry frequently to mean gas that is marketable at the wellhead also, as I understand it; dry gas.

The Witness: That is right. It is gas that is produced from what can be termed a gas well which in turn is a well that is connected to a gas strata and not to an oil strata.

Presiding Examiner. But its liquid hydrocarbons and the like may vary a great deal.

The Witness: Yes. You may have a great deal of natural gasoline and propane-butane in so-called dry gas. You are exactly right.

Presiding Examiner: I wanted for the purpose of your testimony to show you are only speaking of two classes, residue gas produced with oil and dry gas produced with other than oil.

The Witness: Other than associated with oil. That is right.

Mr. Kurtz: Do you have a percentage between your residue and your dry gas that you like to maintain?

The Witness: Yes. I was coming to exactly that point.

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Now, here is what we are shooting at. One of the reasons that we want to gain access to the reserves of the Inter-Mountain area, that is the Rocky Mountain area, it is generally known as, is because that seems to be predominantly a gas area and to have comparatively little oil. I don't say it hasn't got any oil but it has comparatively little oil. It is illustrated by the fact that over here at San Juan there is one substantial oil field only. But the rest of it is gas. You go up into these other fields that are shown along the Pacific Northwest line, and most of them are gas—there are one or two oil fields, but very little.

Now, you get up to Canada and it is predominantly gas. There are substantial oil fields in Canada, but I believe this is generally true, that along the eastern edge of the Rocky Mountain area the gas predominates far over the oil.

Turner Valley I believe is a very good oil field, but at the moment there aren't too many of them.

Now, our thought is, following your question exactly, that as the company expands, we want to cut down that ratio for two reasons. One, from an operational standpoint, to be able to be sure to supply the gas when it is needed because, as I explained a while ago, it can happen that your scarcity occurs at the most important and critical time, namely, on cold days. So we are planning both by exploration, purchase of gas in place, and purchase of gas at the mouth of the well, to expand

the amount of dry gas that we depend upon so as to reduce the percentage between dry gas and residue gas.

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From an energy standpoint, this 1,300,000,000 cubic feet of gas a day, of residue gas, that we market, which otherwise would have to be burnt in flares unless we or someone else marketed it—I am not saying somebody else couldn't market it, but I say we do—represents 216,000 barrels of oil a day. That is the amount that is saved. And you get at that figure very simply because from an energy standpoint, a barrel of oil is the equivalent of 6,000 cubic feet of gas. That is a figure—different barrels or different grades of oil vary but you can use 6,000 cubic feet of gas on the average as the equivalent of a barrel of oil, and you get out of the 1,300,000,000 cubic feet of gas 216,000 barrels of oil which are saved every day by reason of that marketing.

Now, there is another point if I may make it. We are at the point now in the quantity that we are marketing that we should not take on any substantial amount of additional residue gas unless at the same time we take on a substan-

tial amount more of dry gas because we cannot afford to run the percentage up and we ought to run it down.

Mr. Kurtz: Well, what I was interested in, Mr. Kayser, was

[redacted]

the percentage. For instance, maybe we can answer it this way. As of today the volume that you purchase of residue gas and the volume that you purchase of dry gas, with that you are able to meet your commitments.

The Witness: That is right. About 50-50 is about the way it is today. We are marketing about half of our—we are satisfying about half of our market with residue gas and that we regard as being a little risky for the size of the operation we are carrying on.

Mr. Kurtz: One other question on that. You mentioned this adding days to the proration orders of Texas. I gathered from your statement that that was controlled by the market demands for oil.

The Witness: Entirely.

Now, the New Mexico Commission has their own method of regulation, but the two states are operating right jam against one another in Lea County, and necessarily the orders of the Railroad Commission of Texas on proration have a reflected effect in New Mexico because the same factors that influence the Texas Commission influence the New Mexico Commission.

Mr. Kurtz: I see.

By Mr. Shannon:

Q. Mr. Kayser, I think you have already explained it, but it is important. Would you state the benefits of the merger from the standpoint of this problem of marketing residue gas?

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A. Yes. It is obvious that by putting the two systems together, the Pacific Northwest markets very little residue gas, It has access to very little residue gas. All of the potential, not all of the potential but I would say roughly 90 per cent of the potential to which they are connected is dry gas, with the result that unquestionably we would greatly improve our dry gas situation relative to—versus residue gas by the merger.

Presiding Examiner: When you spoke of dry and residue gas being about 50-50, you meant as the situation now exists on the El Paso system alone.

The Witness: That is correct. That is correct. That is what we are talking about.

Presiding Examiner: Thank you, sir.

The Witness: The percentage will be substantially reduced when you consider them on the merged basis.

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By Mr. Shannon:

Q. Mr. Kayser, what effect, if any, will the merger have upon the capital cost of making newly discovered reserves available to customers? A. Well, you can just look at the map and the lines of these two companies merged into a single system will run fairly close to all the potential areas of reserves. That means that it will reduce the amount of capital cost that it takes to connect those reserves into the market, and I mean that for all the market because as we explained this morning, gas flowing into this line in any one place, because of the flexibility of operation, because of the many inlets into the principal markets in California, can be of advantage to all the customers.

Consequently, gas found in the Rocky Mountain region can be connected similarly as the Big Piney Field shown

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on the map there in Wyoming. You have a little branch line of some 60 miles length, I think it is.

Now, actually the original project put a comparatively small line—I believe it is a 16-inch line—in there. Now a 30-inch line is applied for to be run to that field, but you only have to run it that 60 miles. So that the reserves that are available for all of the markets can be connected with—I wouldn't say the minimum capital cost, but very much less capital cost than if you operate them separately.

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Q. Mr. Kayser, coming now to the matter of operations, to what extent in your opinion would the merger of the companies provide a greater assurance of uninterrupted service to the customers as contrasted with two companies operating independently? A. Well, with gas in large quantities coming from the extreme northern end of the line, northwestern end, and with gas coming from the middle and with gas coming from the extreme southern end, you have a flexibility of operation that you can not achieve with a pipeline that has one source of supply and goes a thousand, 1,500 miles to a delivery point, and I can illustrate it by that map right here.

Presiding Examiner: You are speaking of Exhibit 1 now.

The Witness: Yes, sir. Let us assume that the line shown

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on the map from south of Salt Lake down to Las Vegas as connecting into California were constructed. We call it, I believe, the Salt Lake line. It would come from Rock Springs down to the point south of Salt Lake and on to the California border. So that you would have into the California market three gatewa. . One, starting at the top through the gateway on the Nevada-Colorado line, the proposed new one. Two, you would have the gateway

at Topack; and three, you would have the gateway at Blythe.

Presiding Examiner: You are talking about California alone?

The Witness: Yes sir. I am just showing the connection of the systems into California alone.

Presiding Examiner: All right.

The Witness: Now, let us assume that something happened and 100 million feet of gas were cut off from the Canadian source. I don't mean permanently. We are talking about continuity of service. Cut off for a day or two. That has happened.

All right. It is possible that not a single customer may know anything about it except what he reads in the newspaper because that 100 million could be deducted from the delivery at Las Vegas and made up in deliveries at Topack and at Blythe.

Now, the reason for that is that in the lines from the San Juan Basin to Topack, we have 100 million of spare capacity.

[redacted]

We have to have that in order to be able to effectively use the dry gas that is available to us in the San Juan Basin to take care of the vagaries of residue gas out of the Permian Basin. So, we have that hundred million capacity.

In addition we have 50 million of capacity, 50 million a day, we will understand, in the Southern system from the Permian Basin around by El Paso, and so forth, to Blythe. But we also have 50 million of excess capacity from the Permian Basin up by Gallup into the place where the San Juan Basin joins on just above Gallup.

Now, with the result that if you lost 100 million out of Canada, nobody need suffer. You just kick up 50 million at Blythe and 50 million over at Topack or kick the whole

100 million up at Topack, depending on how you wanted to route it.

Now, if you had the loss of 100 million in San Juan, you could bring 50 million the northern route around by Gallup, what we call our Plains line, and 50 million around by the southern route to Blythe, and you have got the 100 million to make up the difference. So that nobody gets cut off.

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Mr. Kurtz: When you say nobody gets cut off, that same answer would apply to any customer on your system, would it?

The Witness: That is right. There is not a customer on the system that need know about it. And everybody gets his gas his gas for that same day, but through a different gateway. That is the advantage of it.

Mr. Kurtz: Thank you.

By Mr. Shannon:

Q. Mr. Kayser, do you anticipate that with the consummation of the merger, increased volumes of gas would be transported from Canada to the States of Washington, Oregon, and Idaho, for service to the various markets, including California? A. Yes. That we regard as one of the important aspects of the merger.

Q. Now, what effect in your opinion would the transportation of such increased volumes have on the unit cost of transporting gas to the markets in Washington, Oregon, and Idaho? A. It is axiomatic in the industry that the most economic method of transporting gas producing the lowest unit cost is by high pressure, large diameter pipelines, transporting large quantities through such lines.

Now, the people, the consumers of Washington, Oregon, Idaho, and Utah, for that matter, will have the advantage of the fact that the whole conception of this plan is to

move—I don't mean tomorrow morning but I mean in the future, in the development

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of the area, large volumes of gas down from Canada along these lines, moving ultimately to the California market and to the general market of both El Paso and Pacific Northwest.

Now, the advantage is that all of the communities that are within economic reach of the Pacific Northwest Pipeline in Washington and Oregon and Idaho will have the advantage of that low-cost transportation that is afforded by a high pressure, large-diameter pipeline.

Now, we are speaking by the book on that for this, that we have already lived through that experience, particularly with the State of Arizona, and we have lived through it in the southern portion of New Mexico. When we started to California in 1945 and 1946, there was complaint on the part of Phoenix that now, here you are sluicing all this gas out from under us and we don't get any advantage out of it and we are inclined to oppose it.

I showed them where the unit cost of bringing the gas to Phoenix would be even reduced rather than increased, and that obviously nobody can corner gas. I mean, it is going to go to market and nobody could say that the gas would not go to the market of California. And the same is true in this instance here.

Now, Phoenix wanted us to supply them 40 million feet more of gas and we only had a 10-inch line leading into Phoenix and a 12-inch line leading into Douglas and 16-inch —one 16-inch

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to El Paso, and we ran the figures from an engineering and economic standpoint and we couldn't supply that 40

million feet of gas to Phoenix at a price that would be satisfactory to them.

Now, that negotiation was going on at the time we were negotiating with California, and, of course, the results of the negotiation with California, we built a 26-inch, 825-pound line, and we simply included enough to serve Phoenix and have on every single expansion since then included the demands of all the customers along that line, with the result that every single one of them gets the advantage of the low-cost transportation of gas in high-pressure pipelines.

Now, you can look at the map. Our policy was to serve every community within economic reach of our line and, as a matter of fact, we gave the Governor a letter, the Governor of Arizona, saying that we would serve everyone that was within economic reach and if we had—if there was a question about it, an argument about it, we would give anybody a tap that was willing to build a line to our line. So that we made the service available in all events. The truth is that nobody has built any. We have built them all. But it is all right. We think that was a good thing to do because you can look at the map of Arizona and you can see that even though it is an arid state, it has a lot of branch pipelines and there isn't a community in Arizona of any size at all that doesn't have natural gas service.

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Now, the same thing is applicable to Washington, Oregon, Idaho, and the other places it is to go. We are willing to say and we have said that it will be our policy to serve every community within economic reach of those pipelines if the merger is approved.

Q. Mr. Kayser, what is the present financial position of Pacific Northwest? A. It is not satisfactory. 1957 showed a loss of $2,067,000.

Mr. Kurtz: May I have that figure again, sir?

The Witness: $2,067,000.

Mr. Kurtz: Thank you.

The Witness: However, Pacific Northwest has a very substantial capital gains profit in the 1,100,000-odd shares of stock of West Coast Transmission that it owns, and in order to not default in the payment of dividends on its preferred stock, it sold 220,000 shares of that stock to the El Paso Natural Gas Company at the market on the date of the sale.

Now, the advantage of that, obviously, was in the fact that we gave them the right to repurchase so that we would not be in the position of riding them in this situation. But, of course, it is a genuine complete sale and they made the profit and have used the money in their business as well as to pay the dividends on their preferred stock.

Q. What effect will this financial condition of Pacific

have on its ability as an independent company to finance expansion of its system? A. It will make it exceedingly difficult for them as an independent company, now, not connected with El Paso or anyone else, to finance those extensions.

Mr. Kurtz: Are they having any trouble to date financing those connections?

The Witness: They are not because we are taking care of the situation.

By Mr. Shannon:

Q. Mr. Kayser, upon consummation of the merger, what plans, if any, does El Paso have for the extension of Pacific's facilities to provide additional service in its market areas? A. We have our engineers making a study of all of the possible economic extensions that can be made. We have completed those studies on certain areas that are

almost obviously ready for an extension, and we have firmly stated and are willing to firmly state it now that if and when the merger is approved, we will finance—we will build those lines. That is all there is to it.

Q. Mr. Kayser, would you briefly comment upon the ability of El Paso following the merger to finance the expansion of the facilities of Pacific which you just mentioned as contrasted with the ability of Pacific without the merger to do so. A. Well, it is obvious that a company of the size and

experience of El Paso would not have any difficulty in financing those extensions. El Paso could do it by itself if it were not merged, if it had a reason to do it. But it is obvious that the merged property will have a much stronger financial position and it will be easier for El Paso even to finance it after the merger than before, and that derives out of the fact that any investor in looking at this merged company will be—and those who have looked at it at our suggestion have come to the conclusion that it is exceedingly strong from the standpoint of the service of its market. It has the gas at both ends and in the middle, adequate potential as well as presently proven, and that the financing of the project will be very easy.

Q. Now, Mr. Kayser, would you comment briefly on the rate aspects of the proposed merger? A. As stated in the application, we do not propose in connection with the merger that any change be made in the rates presently charged the customers of El Paso or the rates charged customers of Pacific Northwest. Our plan is that in the event the merger is granted, El Paso will make a thorough study of the rate situation of Pacific Northwest's portion of the system, taking into account the improvement of earnings of Pacific Northwest that will inevitably arise out of carrying out the plans that we have in mind.

It is our belief that those plans, if those plans are consummated, a very substantial improvement will be made in the

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earnings of Pacific Northwest, and we intend to try to demonstrate that in a moment.

In addition, by that time the business which is within reach of the present pipelines can have been attached very much to the improvement of the company's earnings. After such results have been attained, then the question of what rate increases would be necessary so that the customers of Pacific Northwest would be paying such rates as will permit Pacific Northwest's properties to earn a fair return upon their investment, would be carefully considered.

After the correct answer is obtained to that question, application should be made to increase the rates if necessary. The policy of the El Paso Company will be that the rates of Pacific Northwest, that is, the rates applicable to the customers of Pacific Northwest, should be such as to earn a fair return upon the properties which have been built for their service. We do not think, and it will not be our policy, that the customers of El Paso, as El Paso is now constituted, should be burdened with the cost that may be necessary to serve the present customers of Pacific Northwest.

It will be our aim and purpose to so improve the use of Pacific Northwest's facilities that the amount of such increase of such rates, if any, will be comparatively small and not burdensome upon anyone.

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Q. Mr. Kayser, in your opinion, are there any advantages of the proposed merger in addition to those you have

already covered? A. Yes, there are dollar savings, as we referred to in

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our application, in connection with the combination of Engineering Department executives, Accounting Department, and so forth, and we have made a fairly comprehensive study of the things that can be done, and Mr. Steen, our Vice President in charge of Pipeline Operations, will follow me and give those in detail.

However, I do want to say that I have gone into them with care in connection with the other executives of the company and that his testimony represents the consensus of our opinion.

Now, I want to make this statement, however, in that connection:

Pacific Northwest, because of its tight financial position, is not employing or using the personnel that it would use if it were being operated by a company that was making its return. Mr. Silloway will testify more fully to the details of that matter, but we are taking that into account in our dollar savings.

In other words, we are figuring what it will cost in the way of the departments that we deal with: Engineering, Accounting, Executive, and so forth, to staff them properly for efficient and safe operation.

Now, that is the true comparison because, obviously, the company, as Mr. Silloway will tell you, can't go on in the tight position it is in.

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Mr. Kurtz: Do you mean to say that that planning from a 3.53 return to five, and these other plans, that you don't propose any rate increase on Pacific's system until 1961 or 1962; is that what you are saying?

The Witness: Well, no. I am saying that we will—our own thinking about it is that we propose to take into account—first, we would consider it to be not good business to make any application for any rate increase until we had operated the property for a year.

Now, we would then expect to study the whole situation, the improvement in its earnings, the prospects for additional markets, and the effect of this; and by that time we would hope to have a certificate to cover the expansion.

Now, if we could see through, we wouldn't expect to make

a rate application at all. But, unless you can see through, why, it is pretty hard to carry that load.

Mr. Kurtz: In other words, what you are saying, then, is that for a year you do not plan on putting any rate increase into effect regardless of your status.

The Witness: That is exactly our plans. That is going to be heavy to carry, but here you have got to remember this now:

This property is just introducing natural gas into a new area, so that you have to approach it from a promotional standpoint or get out of the business.

Now, we think enough of the property that it can be made to make its charges. We think enough of the total situation of the merged properties, that is, the advantages all around to our customers and to verybody concerned, including the corporation, ourselves to carry the load. Now we are willing to undertake to work it out with as little disturbance as possible to the end that we get as much business as we can as soon as we can get it.

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By Mr. Shannon:

Q. Mr. Kayser, with reference to this new project that you described just before the recess, to bring 400,000 a day into California, what is the proposed rate that would be charged by El Paso to the Southern California companies? A. The rate at the Nevada-California gateway, proposed gateway, is 40 cents to the Southern California gas companies, and I would like to say our whole theory of approaching this matter is to improve the situation of Pacific Northwest without putting the burden on any of the El Paso customers, as I said.

And I want to call attention to the fact that the effect of what we are doing is making this gas available to California and, in truth, this 40 cents is the lowest price of any gas that is now proposed to be delivered to the California market.

The Trans-Western pipeline that is proposed, an application for certificate is on file with the Commission, proposed a rate for 800 pound gas delivered at Topock of 45 cents on 100 percent load factor. This would be about 47 cents on an 85 per cent load factor, whereas what we propose is 40 cents on an 85 per cent load factor.

Likewise the Pacific Gas and Electric Company's proposal to bring gas from Canada to the San Francisco and Bay area provides for a plus or minus 50 cent rate delivered at that point.

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Mr. Kurtz: At what point?

The Witness: At the San Francisco Bay area. I do not remember the exact point, but it is at San Francisco.

By Mr. Shannon:

Q. Mr. Kayser, would you briefly summarize this merger as you see it? A. Well, quickly summarizing, the first

point is that it gives access to all customers, to all sources of supply, within economic reach of the market.

Second, it produces a low unit cost of transportation for the service of gas to all of the customers along the Pacific Northwest pipeline in Washington, Oregon, Idaho, Utah and so forth.

And it has the advantage, the merger has the advantage, that the El Paso, or merged company, will be in a position to make that service available at the earliest possible moment—much faster than it could be through an independent operation of Pacific Northwest.

It provides a more stable, continuous and dependable service for all of the communities by reason of the flexibility of the operation of the merged properties. This arises out of the fact that it has large supplies at both ends of the system as well as in the middle.

It makes possible the maximum expansion of Pacific Northwest so as to use to the maximum the capacity that has already been built into the system. As witnesses following me will show,

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the capacity of the pipeline is far in excess of the amounts that it is now delivering.

It has the other distinct advantage that it will give to the customers of Pacific Northwest a strong financial institution that is able to make the maximum use of the properties to the end that whatever rate increases that have to be made will be minimized so as not to be burdensome upon any of those customers.

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Stuart F. Silloway

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Direct Examination

By Mr. Payne:

Q. Please state your name, address and occupation? A. My name is Stuart F. Silloway, and I reside in Greenwich, Connecticut.

Since September 1st, 1958, I have been President of Harriman,

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Ripley & Company, an investment banking firm in New York City.

Q. Please summarize your business experience prior to September 1, 1958? A. Well, I was employed by the Mutual Life Insurance Company of New York in New York City from 1933 to 1956, and during this entire 23 year period I was in the investment end of that Company's business with the exception of a two-year period, 1942 to '44, in which I was the Company's Treasurer.

From 1954 to '56, I was Vice President for Finance for the Company. In the summer of '56, I resigned from Mutual Life Insurance Company of New York and became President of Pacific Northwest Pipe Line Corporation. I served as President of Pacific until I resigned to go with Harriman, Ripley & Company, as I said, on September 1st of this year.

I was elected director of Pacific in the summer of 1956 and am still a member of its Board.

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Q. Please state in general terms whether your early analyses disclosed that there were any problems with respect to Pacific Northwest's proposed operation. A. Well,

in our original deliberations, which culminated in the Mutual's decision to purchase some of these bonds, we always felt that there were two major questions concerning the earning power of the project. The first of these two questions related to the extent and deliverability of Pacific's natural gas reserves in the San Juan Basin; and the second question was concerned with the extent and speed with which natural gas could be introduced into this territory in which natural gas was a comparatively new fuel. In other words, we were concerned about the period of time that it would take to develop a market to load that system.

Q. After you assumed the presidency of Pacific, what was your experience with the first of these problems? A. Both of these problems continued to be a source of concern in the early stages of Pacific's development. The volume of San Juan Basin reserves, frankly, have exceeded our expectations, but the deliverability of certain of the wells has shown an important decline after being attached to the pipeline. The development of reserves and deliverability along the route of Pacific's line has proceeded satisfactorily. Except for certain present limitations on Pacific's ability to encourage development, which I shall discuss elsewhere in

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this testimony, Pacific's gas supply for its presently certificated markets has ceased to be a cause of serious concern, or a cause of any concern.

Mr. Kurtz: You say it has ceased?

The Witness: Yes, sir.

By Mr. Payne:

Q. Are there unusual conditions affecting the gas supply of Pacific Northwest? A. Well, the Pacific Northwest system is unique in several respects when contrasted with other natural gas systems. First, its gas supplies after

the authorization of the Canadian project, are found at both ends of the system as well as along its route; and second, the construction of the additional facilities to receive this Canadian gas raised the capacity of the system from 343 million feet a day to about 646 million feet per day before the initial system was ever connected to market, before it was ever completed. And thirdly, the major source of Pacific's initial gas supply is represented by gas which Pacific itself had to develop and produce from leasehold acreage which it owns. In many other systems, the primary source of gas supply comes from gas purchase contracts, from what we call contract acreage. And this requires that Pacific spend large sums annually for well drilling and for gathering costs in order to develop this acreage and to maintain the supply for its certificated market.

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Q. What conclusions do you draw from these differences between Pacific and other pipelines which you have just pointed out? A. Well, I think there were two main obvious conclusions. One, the Pacific Northwest system requires that important new loads be attached in order to utilize effectively the large capacity which was built into this system to accommodate that Canadian gas project. And secondly, large capital expenditures are required for well drilling and gathering costs which, when combined with the construction of necessary sales laterals, impose a substantial annual requirement upon the company for new funds.

Q. What effect did the construction of the facilities to accommodate Canadian gas have upon the Pacific system? A. Well, the importation of large quantities of Canadian gas required the expansion of the capacity of the system far beyond that which was originally certificated. It was not feasible to build the original system first and then

add to it to accommodate Canadian gas when the latter became available. Therefore, the investment in facilities to accommodate the Canadian gas had to be made during the initial construction program.

Putting it another way, Pacific incurred the debt and was subject to the debt service requirements connected with the Canadian expansion at a time when its initial system had not

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been completed and before Canadian gas was made available to it. The net effect was to impose upon the company an additional financial burden during its early years of operation.

Q. Following your connection with Pacific, did you have any further experience with respect to these problems? A. Shortly after I joined Pacific it became apparent to me that a relatively longer development period would be necessary in order to load the system effectively to utilize the large capacity which had been built to accommodate Canadian gas, that is, a longer period of time than had been originally forecast. The relatively lower availability of gas from the company's wells in the San Juan Basin, while not impairing its reserve position or its long-range deliverability position, imposed a heavy capital burden upon the company in the early years for additional well drilling costs. And as a result, the conclusion was reached in the very early stages of Pacific's initial operations that the earnings of the system would be relatively low in the first few years and, therefore, that all operating and maintenance expenses should be held to an absolute minimum.

Q. What has Pacific Northwest done with respect to operating and maintenance expenses? A. Well, the Pacific system has been operated at the lowest possible cost consistent with sound pipeline practices for an initial operation.

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Q. In your judgment can Pacific expect to continue to operate in this manner? A. Well, no, sir, I do not think so. I am convinced that Pacific can not be operated for a protracted period of time with due regard for safety and complete dependability of service without increasing the number of personnel in practically all categories, and probably without spending more money for maintenance. What I am saying is that over the years, with the wear and tear which will result from the operation of the system, Pacific can not hope to render dependable and efficient service with the relatively low number of personnel, and the relatively low expenditures for maintenance which have characterized its operations thus far.

Q. How did Pacific's revenues for 1957 natural gas sales compare with the revenues for that year as estimated in May of 1956 at the time Pacific filed its initial tariff with the Federal Power Commission? A. Well, the 1957 revenues were substantially below the estimates. Pacific's sales were disappointing, both in volume and in character. The sales volume averaged, for the 365 days of that year, approximately 341 million feet per day as compared with about 390 million feet per day, which was predicted. And furthermore, this reduction of approximately 50 million feet per day in volume incurred primarily in the distribution class of service, that is, the deliveries of gas to distribution

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companies for resale. So that 1957 sales of the company were preponderantly sales to pipeline companies, to other pipeline companies, and the sales of gas in the interruptible category, both of which classifications of service produce lower unit prices than do the sales for resale to distribution companies. This disappointing rate of increase of distribution companies sales resulted from a variety

of completely unforeseen causes. For example, the Idaho distribution companies were delayed in their development because of legal difficulties which were protracted, I think, far beyond anyone's expectations. And then there were two other significant factors contributing to the poor sales volume. First, the level of business activity generally in the Northwest and along the company's pipeline; secondly, the relatively mild winter in which we had temperatures prevailing about 17 per cent above normal.

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Mr. Kurtz: You are talking about this past winter?

The Witness: Yes, sir, the '57-'58 heating season.

The reduction in sales volume, particularly in the firm category, therefore, resulted in the annual revenues for '57 being almost $3 million less than had been anticipated at the time the initial tariff filing was submitted, that is, less than the estimates that were prepared at that time.

By Mr. Payne:

Q. What was Pacific's experience with respect to revenues available from Pacific's gasoline plant as compared to those which had been estimated at the time Pacific filed its tariff? A. Well, the revenues from the sale of products were about $3,400,000 less than had been forecast. And this was due to a number of factors, again, first, that the quantity of gas run through the gasoline plant was about 110 million cubic feet per day less than had been estimated. In addition, the recovery of liquids from the gas which was processed in the plant amounted to about .62 of a gallon per Mcf instead of 1.2 gallons per Mcf which had been anticipated and used in the calculation of the initial tariff filing. And also, the price obtained for the liquid suffered in the general decline in the prices for this industry, and Pacific netted about 3 cents per gallon

on products as compared with 4¼ cents that were used in the estimates.

Q. What was the net income of Pacific for the year 1957? A. Well, as a result of the factors I have just mentioned,

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the earnings for the company before preferred dividends in 1957 represented an actual loss of $2,067,000.

Q. What has been the experience with Pacific's operations in 1958? A. Well, the result of Pacific's 1958 operations to date has been importantly better than was experienced in 1957. This is due in large part, however, to the sale of 100 million cubic feet of gas per day which Pacific is currently making and has been making to El Paso. In addition, the market customers of Pacific have continued to attach load, and total deliveries of gas have been somewhat better than in the preceding year. In contrast to the 341 million cubic feet per day average in 1957, we anticipate that 1958 sales will average pretty close to 500 million cubic feet per day.

Q. You mentioned the requirements on Pacific to provide additional capital. In your opinion, could Pacific as an independent corporation obtain the necessary funds to finance capital outlays required in 1959 to serve its presently certificated markets? A. Well, with the load growth in its certificated markets, and the earnings that we can now foresee, I think that it would be extremely difficult for Pacific to finance its requirements in 1959 as an independent company, although it might not be impossible—but I say difficult.

Mr. Kurtz: What earnings do you foresee, if I might

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interrupt?

The Witness: In 1959?

Mr. Kurtz: And 1958. And this year also.

The Witness: Well, in 1958, again, Pacific will have a deficit and it will not, in my judgment, it will not, have earnings for its preferred dividend requirements.

Mr. Kurtz: By how much?

The Witness: Well, you recognize, Mr. Kurtz, at this stage it is somewhat of a guess, but I am going to say something on the order of maybe a million and a half dollars is the amount by which it will fail to show earnings.

Mr. Kurtz: And in '59?

The Witness: I do not think—there are so many factors that would have to enter into the 1959 projection, Mr. Kurtz, I would not attempt to be precise. I would say this, however,

. . . . . .

The Witness: What I said in respect to 1959, Mr. Kurtz, was that I thought it would be difficult for Pacific to do the financing that would be required if it were an independent system—I did not make any reference to what I thought earnings would be in 1959.

Mr. Kurtz: Well, the reason it would be difficult would be

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because of the earnings, wouldn't it?

The Witness: That would certainly be a strong contributing factor, yes, sir.

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By Mr. Payne:

Q. One factor that would go into the ability of Pacific to finance would be the generation of cash or cash throw-off.

Do you have any observations on the effect on Pacific's ability of finance its cash throw-off? A. Well, thinking in terms of the load growth and the certificated markets

that would come about in the normal course of events, that really forms the basis for the statement that I previously made, that Mr. Kurtz inquired about, namely, that I think it would be difficult for Pacific, as an independent, to finance its capital requirements in 1959.

On the basis of operations, as we would view them, Pacific will have to devote in 1959 about eighty per cent of its total depreciation charge-off to sinking fund requirements on its debt, so that there will be only a very small amount of cash throw-off for capital expenditures. And while it might be possible for the company to arrange financing for its 1959 capital requirements, I do not think it could be done on terms which would be advantageous to the company or to its customers.

I think that the low earnings which should logically be expected would make themselves felt in the form of higher costs of new money, which must ultimately be repaid by the company, or perhaps in the form of curtailment of service.

Q. What would be the effect of financing at what you term "higher money costs"?

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A. Well, if it becomes necessary for Pacific to finance additional capital expenditures upon onerous or burdensome terms, it seems to me that whole new elements of higher cost will be introduced into Pacific's economics and would have to be reflected in its rates.

Q. Is there any other alternative to procuring this additional financing? A. Oh, yes. The drilling of wells and the construction of gathering facilities in the San Juan Basin could be further curtailed if not eliminated entirely. And, in that event, however, it is likely that a substantial portion of reserve acreage would be lost, since it would revert to the former owners under the terms of the sub-

leases and operating agreements by which Pacific holds these leaseholds.

Also, it would be possible for Pacific to eliminate investments in gathering facilities in various Rocky Mountain areas where important gas reserves are in the process of development. And this might result in the loss of some reserves, now under contract, and it certainly could be discouraging to the producers in those areas and would retard their development programs, I would think, materially. And Pacific would risk the diversion of this additional gas to other markets.

I think, also, Pacific could cut back on investments in new or additional sales lateral facilities to markets which may require new or additional service.

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Q. Does Pacific's present situation have any effect on its customers? A. Well, it certainly does from the point of view of all the customers of the system, both present and prospective. It has to be emphasized that Pacific's present situation represents a number of serious problems:

First, as a result of low-level earnings and the slow rate with which additional load can apparently be attached, it may be necessary for Pacific, at least as an independent entity, to make application for a further increase in its rates.

And, secondly, both the quality and the quantity of additional gas reserves might be somewhat uncertain, since additional financing for well drilling and gathering facilities and other additions to plant will be difficult to achieve except on possibly very onerous and expensive terms.

Q. Does Pacific's operating experience lead you to any conclusions with respect to the availability of additional supplies of gas to Pacific's customers? A. Well, the relatively small load growth thus far of Pacific's customers means that the fullest and greatest benefits which Pacific's

market can realize by reason of Pacific's connection to Rocky Mountain gas areas, gas reserve areas, may not be achieved. The advantage to Pacific's customers of being connected to these reserves is that substantial future long-term gas supplies can be made available to them.

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To make effective use of additional reserves, the pipeline must be prepared to take them into its system in whatever quantities, whenever, and within reason wherever they are available.

Now, the relatively slow development of Pacific's markets, that is, the area that it has been certificated to serve and the related scarcity of funds available for outlay in projects promising relatively distant benefits, indicate Pacific as an independent corporation will be unable to encourage development of natural gas reserves in the Rocky Mountain area. And the company will not be in a position to conduct broad exploration activities of its own, nor will it be able to attach promptly gas deliverable from isolated production by small producers, and so provide them with working funds with which to finance further exploration and development activities.

On the other hand, the financial resources of the merged companies, the size of them and their rate of growth in their combined market areas, as well as the flexibility in management of deliveries from their sources of gas supply, all combine to make it a sound corporate practice for the merged companies to foster steady progress in natural gas exploration and development activities throughout the entire Rocky Mountain area.

And such a program would be the most effective in the long run and assure that the tremendous gas reserves located

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in the sedimentary basins of the mountain area would become available to all of the customers of Pacific and El Paso.

The program would avoid any future crash exploration and development programs and avoid, too, the possibility that some of these reserves might sometime be lost to these markets.

Q. Do you have any similar conclusions with respect to the availability to Pacific's customers of additional Canadian gas supplies with Pacific as an independent corporation as compared to the combined system? A. Well, I believe that additional volumes of Canadian gas would probably be authorized for export only in relatively large volumes, say, on the order of 150 million feet per day. And increments of this magnitude will be beyond the capacity of Pacific's markets, standing alone, to absorb.

Substantial additional markets must be available to Pacific if it is to bring additional Canadian gas into its system; otherwise, these volumes may be diverted to other purchasers which have neither the desire nor the obligation to serve the load growth requirements of Pacific's presently certificated market area.

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The merged system will provide the additional market demand necessary to enable Pacific to import these relatively large increments of Canadian gas. As an example, Pacific has entered into a contract with Westcoast to import an additional 150 million cubic feet of gas per day to be purchased by Westcoast in the Savannah Creek area of southwestern Alberta. Now this contract is made feasible by the market demand of the California markets to which Pacific has access through the El Paso system and the proposed 400 million feet per day line down to Las Vegas

that Mr. Kayser has described. The contract could not have been justified on the basis of the demand of Pacific Northwest's markets alone. El Paso and Pacific are parties to a service agreement dated August 28, 1958, under which El Paso agrees to purchase from Pacific the volumes made available under this Westcoast contract. Mr. Kayser's testimony in this case, both as to the policy of the El Paso company and as to the history of its service of the intervening and relatively small demands of its Arizona customers makes it perfectly clear that Pacific's present customers, as customers of the merged system, will share in these increased volumes of imported gas which might otherwise be lost to them.

Q. Do Pacific's presently inadequate earnings pose any problems with respect to the acreage which Pacific has contracted to develop? A. Yes, under the terms of the overriding royalty

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agreements under which Pacific has acquired the acreage in the San Juan Basin which forms the backbone really of its gas supply, substantial additional outlays for drilling and gathering and the dehydration facilities have to be made each year in the early years of the development of that field, and Pacific has already found it necessary, for financial reasons, to reduce this outlay for these expenditures on this acreage in the Basin. And when the proceeds of 1957 and 1958 financings of Pacific have been fully utilized, a sharp reduction in capital outlays on this San Juan Basin acreage must be made. I believe that future reductions of these expenditures can be made only at the risk of losing a substantial quantity of acreage. And this will be detrimental to Pacific's customers in the long run in my opinion.

Q. What is the situation with respect to additional supplies of gas in areas north of the San Juan Basin along

the route of Pacific's lines? A. Well it is clear that the requirements of Pacific's markets alone will not provide the necessary increase in demand to encourage early drilling and development of this area. For example, Pacific's present gas operations will not justify offering to producers generally a contract requiring Pacific to take or pay for gas available in substantial quantities for additional reserves. Nor will it be able to offer the producers other financial inducements to encourage

drilling such as cash advances which would be repayable out of gas, etc. Similarly, Pacific will not be able to agree to make investments in gathering facilities or other field installations which in some cases may be necessary to assure the dedication of these new reserves to Pacific's markets.

Mr. Kurtz: What fields do you have in mind, Mr. Silloway?

The Witness: Well, I do not have in mind any specific areas, Mr. Kurtz. There is an awful lot of drilling and development going on in the Rocky Mountain Basin areas, as you know, and we just believe confidently that from work that has already been done that there will be additional reserves found that will have important deliverability. And what I am saying is that Pacific alone, by itself, might find it difficult or impossible to get into some of those areas that it should get into.

Mr. Kurtz: That is unless they found a new market?

The Witness: Unless they found a new market, yes, sir.

Mr. Kurtz: Now you mention the San Juan Basin—before we get too far away from it—a reduction in outlays in the San Juan Basin. Is that because Pacific has an excess supply of gas at this time?

The Witness: No, I was not thinking of it from that

point of view at all. I was thinking of it from the point of view of Pacific's ability to finance the additional well-drilling and gathering that will be required down there in

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order for it to live up to its contracts under those lease-hold agreements.

Mr. Kurtz: In other words, the additional outlay is greater than you had originally thought that it was going to be?

The Witness: Yes, the outlay is greater than we had thought it was going to be, and also Pacific's cash generation is importantly less than we had thought it was going to be.

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By Mr. Payne:

Q. Would you please summarize the outlook of Pacific and its customers with respect Pacific's ability as an independent corporation to render its present service and Pacific's ability to increase that service in the future? A. Well, the Pacific system needs substantial additional loads before its facilities can be effectively and economically utilized. It has to have additional financing to maintain the deliverability from reserves in the San Juan Basin and utilize economically reserves in other areas. In time probably these problems can be worked out.

Pacific may, however, require a rate increase in order to maintain its present service. However, the most serious and pressing problem is the fact that Pacific, standing alone, cannot be counted upon for many years to increase its service or broaden the customer base on which it depends and in whose interest it operates. If it is to be dependent solely on its own markets and its own resources,

Pacific cannot be expected to expand its system and service because the combiniation of low earnings and the slow rate of load growth will conspire to make increases in capacity for small increments very expensive. Its additional capital requirements can be supplied only on relatively unfavorable terms. Its gas supplies for the markets presently certificated are reasonable secure, but additional gas supplies, which are expected to be available in large volume, may well be

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diverted to other markets. Pacific's markets alone will not provide sufficient incentive to encourage drilling. And Pacific alone cannot offer immediate takes or other financial inducements, as I said previously, to stimulate development which I think is advantageous.

The net result of this is that Pacific's markets will not share in the new supplies of gas to which they have a right to look for the satisfaction of future load growth.

Q. What solution do you propose? A. Well, I believe that the serious problems which are a source of concern to Pacific Northwest, to its management, to its employees, its gas suppliers, its security holders, and probably most important of all, its customer companies can be solved immediately through the merger of Pacific Northwest into El Paso as proposed in these dockets, and that it is clearly in the public interest now and in the future to solve these problems in this manner. For a long time, absent rate increases, Pacific would not be the kind of a healthy, sound economic pipeline which can attract new capital and secure the dedication of additional gas supplies and render increased service to its markets. The merger gives Pacific and its markets all the advantages which they might ultimately achieve were Pacific to operate independently, and it gives these advantages right now.

Q. You were president of Pacific during the period when

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the acquisition of its stock was negotiated for by El Paso, were you not? A. Yes, sir, I was.

Q. Will you please state why Pacific insisted upon a stock acquisition rather than upon a merger with El Paso as the form in which the transaction had to be cast? A. Well, commencing about in August of 1956, and continuing through September and October of that same year, Mr. Kayser, the president of El Paso, explored the possibility of El Paso's acquisition of Pacific with other members of the Board of Directors of Pacific and with me. We understood that this could be achieved by casting the acquisition either in the form an exchange of 80 per cent or more of Pacific's outstanding stock solely for El Paso voting stock, or in the form of an acquisition of the actual physical assets of Pacific by merging with El Paso. The latter course required the prior approval of the F.P.C. And this meant that after an acceptable offer was received from El Paso, but before it could be implemented, Pacific would have to file an application with the Power Commission, participate in a hearing of indeterminable length, and await the decision of the F.P.C. as to whether the transaction could in fact be consummated.

Now such a procedure was completely unacceptable to Pacific's management and directors. We felt at that time that the responsibility for managing the affairs of the company could not

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be suspended and placed in doubt during a crucial period in Pacific's affairs.

As of October 1, 1956, as I am sure you all know, Pacific had filed a number of applications which were then pending before the F.P.C. Some of these were applications for permission to make the sale of additional volumes of gas,

and some were applications for authorization to construct facilities to connect additional supplies.

We had at that time developed a capital budget for 1957 requiring approximately $50 million of additional funds to construct facilities which had already been authorized by the Commission and to retire bank loans. At least fifteen million of this amount we had concluded had to be provided by additional equity in the form of common or preferred stock. And Pacific had formulated plans to raise that amount of equity funds by the sale to the public of stock and to provide the remainder of the capital required for this program by the sale of additional first mortage bonds and by bank borrowings.

The headquarters office of Pacific was just at that time being moved from Houston, Texas, to Salt Lake, so that the line, not yet completed, could be operated from the latter city. We were in the process of recruiting and training operating personnel, and some personnel that we already had had been moved to Salt Lake City, and others were in the process of giving up their homes in Texas and elsewhere and moving to Salt Lake

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City. And we felt that at this particular stage of Pacific's career, to consider embarking upon a course of action which would leave the ownership and direction of the corporation in doubt and subject it to the outcome of protracted proceedings before the Power Commission, was just entirely imprudent. That was the conclusion we came to at that time. And it was, and it is my judgment that under those conditions the additional first mortgage bonds that we had to sell could not have been sold, and the public offering of equity securities which we were at that time preparing was just completely not feasible. And the recruiting of competent personnel would have been rendered extremely difficult, if not practically impossible. We felt

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that the morale of Pacific's own employees would have been impaired. So in the light of these circumstances, the obligations of Pacific under its certificates of public convenience and necessity to perform within fixed periods the projects which were authorized by the F.P.C., might well have been impossible of accomplishment.

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All things considered the exchange of El Paso's stock for Pacific stock offered the only method for El Paso to acquire Pacific which was then acceptable to Pacific's management and directors.

And Mr. Kayser was informed of this attitude of Pacific in the course of these negotiations.

Q. Did the form in which the acquisition was finally cast take cognizance of these problems you have described and, if so, how? A. Well, yes, sir, the agreement which was dated November 8, 1956, which was finally worked out between the parties and under which El Paso made its formal offer on January 8 of 1957 to the stockholders of Pacific, was formulated with attention to the circumstances that Pacific had presented.

The agreement reflects some of the solutions for the problems which even the exchange of stock posed. The equity financing required by Pacific's 1957 capital budget was provided by a loan from El Paso in the amount of $15 million, which was payable at the option of Pacific in common stock.

With Pacific's interim problems provided for in the agreement regarding the exchange offer, Pacific's Board of Directors, all of whom were substantial stockholders of Pacific, bound themselves to accept the exchange offer when it was made by El Paso. The offering of El Paso Common B Stock in exchange for Pacific Common was registered with the Securities and Exchange Commission and

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submitted to Pacific's stockholders by a prospectus which I previously said was dated January 8 of 1957.

It was provided that the offer would become effective only if 80 per cent or more of the outstanding stock of Pacific were tendered to El Paso. The required minimum number of shares was deposited for exchange by January 31 of '57, and the offer thereupon was declared effective.

Additional shares continued to be presented for exchange up to the expiration date of the offer, which was May 1 of 1957. And by that time approximately 99.8 per cent of Pacific's stock had been exchanged pursuant to this offer.

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Q. Will you please state what you conceive to be the advantages of the merger from the standpoint of Pacific Northwest's present customers? A. Well, El Paso has resources to develop more aggressively the markets in the Rocky Mountain area and in the Pacific Northwest than Pacific. And El Paso can furnish the additional load, and therefore more effectively utilize Pacific's facilities with the resulting lowering of unit cost of transportation. The small growth increments of the Pacific Northwest markets can be combined with the relatively larger load growth increments of the California market to make additions to service in both areas practical and, I think, very economic.

The addition of the markets of El Paso to those of Pacific will provide incentive for all producers in all of the areas tributary to the Pacific system, and will certainly encourage the development of additional reserves and the attachment of such reserves to the combined system will benefit all of the customers of the combined system.

Large new gas supplies, such as those which may be

available from Canada, can thus be absorbed, and the needs of all customers, including the smallest companies, can be fully satisfied.

El Paso has the resources to work with the producers in all areas tributary to the Pacific system and secure the dedication of the additional reserves to the combined system. The required additional financing for Pacific can be secured on terms much more

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favorable to the ultimate customer if El Paso's resources and credit can be so utilized.

El Paso has the earning power, and it has the cash generation to attract the lending institutions, and the preferred shareholders to insure that their positions and their investments will be fully protected.

Q. What is your conclusion with respect to the public interest to be served by the merger? A. I feel very strongly that by means of the merger the period of years which would be necessary to build into the Pacific system sufficient additional sales and revenues to provide lower unit costs and adequate earnings through the normal development of Pacific's load alone can be very materially shortened.

It is in the public interest of all of the customers of the Western States that they be served by a healthy, growing pipeline system having low unit operating costs backed with adequate and constantly increasing reserves. And I think all of this can be accomplished by the merger.

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Mr. Kurtz: Well maybe we are talking about two different things. I gather the impression from your testimony that you were indicating that Pacific was faced with

possible reorganization under the Chandler Act, for example. That was not in your mind, was it?

The Witness: Well, no, sir, I do not think so. I think that Pacific of and by itself can batten down the hatches, as it were, and continue to operate with a sharply curtailed

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program, with a very small complement of personnel, skimping seriously on maintenance, and being very parsimonious in respect of everything that it does, particularly additional capital programs, and wait over a period of years for further development in load in its certificated market to give it some improvement. But I think that that would definitely be dangerous and serious and not in the public interest.

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H. F. Steen

Direct Examination

By Mr. Shannon:

Q. Please state your name for the record?

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A. H. F. Steen.

Q. And by whom are you employed? A. I am employed by the El Paso Natural Gas Company.

Q. And what position do you now hold with El Paso? A. I am Vice-President and Manager of Pipeline Operations.

Q. How long, Mr. Steen, have you been employed by the El Paso Company? A. Continuously since the year 1931.

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Q. Does El Paso operate an integrated pipeline system? A. In my opinion, yes.

Q. Will you briefly state what you mean by an "integrated pipeline system"? A. In my definition, an "integrated pipeline system" is a system which operates so that all the various divisions or parts of the company's operational system are interdependent to some extent upon the operations of the other parts of the system.

In El Paso's case, its principal sales are supplied from several major production areas which are widely separated geographically. These areas are connected to the chief sales area, the California Border, through two large pipeline systems connected at several points by long, large-diameter pipelines.

These two systems, the San Juan and the Southern

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systems, operate independently insofar as personnel and operating conditions are concerned, but are completely dependent one on the other insofar as meeting the over-all market requirements are concerned. The impairment of operating efficiency of either of the two systems affects in some way the other division's operations rather rapidly.

Q. In El Paso's application now before the Examiner it is proposed that both Pacific and El Paso be operated as a single integrated system.

Would you consider this type of operation more or less satisfactory than the operation of two individual and independent systems? A. In my opinion the single, integrated system would be the more simple and the more economical of the two types of operation. I say this for several reasons:

First of all, the single management, delegating the responsibility for all general company duties, such as engineering, accounting, measurement, and other service type

of functions, is more economical than the operation of two separate organizations; if for no other reason than the elimination of duplication alone.

Second, the single control of one, common, integrated system will provide a completeness and continuity of service not possible to separate corporate units.

Q. Mr. Steen, what would you consider the chief benefit

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of this integrated type of operation that you have described? A. One of the chief benefits that would naturally occur would be the simple dollar savings.

These savings which are appreciable now would become even more appreciable in the future and would be brought about by the elimination of duplication of efforts which exist when two corporations operate as separate corporate entities.

As an example, two engineering departments will duplicate in many instances operations which could be eliminated, two accounting departments, two measurement departments—all of these are only examples of functions wherein duplication could be eliminated.

El Paso is now organized with three operating divisions. Two of these divisions, the San Juan and the Permian Divisions, have production, gathering, processing, and transmission requirements; while the third, the Southern, is purely transmission.

These divisions, each handling in excess of one billion cubic feet of gas per day, are supported by over a thousand people in the various service groups in El Paso. By "service groups" I mean accounting, engineering, measurements, transportation, purchasing, and so forth.

By operating the Pacific system as a division of El Paso, I estimate that savings by the elimination of service function duplication will amount to at least $1,115,000 a year.

Q. Could you please break down this $1,115,000 per year

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figure for us? A. Yes.

I estimate savings in the following order on a yearly basis: Executive salaries, $100,000; savings in the accounting department, $150,000; engineering department, $300,000; measurement department, $40,000; purchasing department, $30,000; liquid sales, $15,000; drilling and geological, $185,000; materials, $20,000; field operations, $150,000. This amounts to approximately $990,000 in itself.

To this figure should be added the savings in financing costs, auditing costs, and regulatory expense, which I would estimate to be around $125,000 per year.

It has been possible to estimate some of the savings from the proposed merger. There are other savings which will result and with respect to which it is not now possible to estimate the dollar amount. But I am sure that these savings and benefits will occur if the merger does take place.

From the standpoint of general operations, the intangible benefits will equal or outnumber the ones that have been pointed out. I will endeavor to illustrate what I have in mind:

In field operations, particularly, particularly in the prorated gas field such as the San Juan Basin, it is no great problem to keep the field in reasonably accurate balance so long as the field furnishes supplies of gas required as part of the over-all supply of one company.

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When several are operating, operating or supplying gas to their systems from the same field, some of the wells are continually over or under produced. Without an exchange contract between the producers situations develop that put an extreme hardship on some of the purchasers, especially the ones whose requirements are small.

Although this situation can be remedied to some extent by exchange agreements between purchasing parties, the operation is much more satisfactory and adds a flexibility when one purchaser is making the gas nomination.

We presently have a proration department in our company consisting of some 35 employees. The merger would offset duplication here as this group would handle all proration and gas settlement matters.

In the Land and Lease Department and in the Right-of-Way Department, numerous files and records are required. It would be more economical for one department to handle these matters instead of duplicating this with two. There are instances where drilling requirements could be minimized in that only one well might have to be drilled to hold leases or prevent offset drainage if the acreage now owned by the separate companies were combined under one ownership.

An integrated communication system, particularly in the field of operation, is certainly more economical to operate than two systems. The capital required for maintaining a stock inventory

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of material would be reduced if only one such inventory was necessary. Of course, here, as in other instances, there would not be duplication of personnel. Quite frequently volume purchasing enables better prices to be obtained. Similar reasoning as above would apply to the dispatching, legal, finance, gas contracts, gas sales, safety, personnel, and various other departments.

One construction department overseeing the overall construction program of the combined companies would certainly eliminate duplication. Also, in all operations, techniques and proven methods developed in 30 years of operating and construction experience would be used in the merged company.

Without question these savings and economies are in the public interest.

Q. Are the saving figures that you quote your own estimates, Mr. Steen? A. I certainly support them. The actual figures were thoroughly considered by each of the operating groups and by our personnel department. I personally consider the figure to be somewhat conservative.

Q. You have said that these savings could be made by the elimination of duplication in service organizations. Would that also apply to the operating divisions as such? A. Yes, it does to some degree. However, my previous statements were directed more to the central or main office

functions of the organization. There would certainly, however, be savings in field operations, especially in the San Juan Basin where the individual companies' operations are in close proximity.

Let me give an example of this. El Paso and Pacific presently operate in the San Juan Basin in the production, gathering and processing of gas produced in the area. In order to economically develop the San Juan Basin to the maximum economic benefit, both to El Paso and to Pacific's customers, a certain degree of integration with regard to the respective gathering systems has taken place.

This has been certificated by the Federal Power Commission. I would estimate that this integration to the extent that it has now taken place, has resulted in a saving to Pacific in capital required for gathering system construction in the range of $4,500,000. As additional gatherings, extensions and development occurs, this condition will continue to increase. This gathering system integration can be summarized as follows:

Where Pacific can more economically install facilities, they do so; and where El Paso can do so, the installation is made by El Paso. An exchange of gas takes place at inter-

connecting points so that both systems are utilized to the maximum possible extent.

We are now operating as Pacific's agent in the San Juan Basin, performing certain tasks for them. When this operation was initially undertaken, Pacific was immediately able to eliminate

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some 50 employees. Of these 50 employees whose services were no longer required in this particular phase, I believe 35 or 40 were transferred into Pacific's other operations, relieving Pacific of the necessity of hiring additional people for their main line operation.

This increase in services on the part of El Paso required the addition of only incremental labor in our manning requirements. Approximately 12 men were added to our field operating forces.

This is an example of what I have spoken of previously in the elimination of duplication. It reflects only a part of what could be expected to occur in the future, and I feel this type of economy will become increasingly greater in later years of operation.

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Q. Mr. Steen, at the conclusion of yesterday's session, you had pointed out a certain amount of integration in San Juan Basin which had been accomplished between the two companies when they were separate independent corporate entities. Does this indicate that the proposed merger is not necessary? A. Definitely not. In fact, the contrary is true. I have indicated certain savings which were accomplished without a merged operation, and it can definitely be said that these savings could have been considerably greater had there initially been one integrated company instead of two.

The amount of time, effort and expense which was incurred in building duplicate field facilities can not be undone. But the limited integration which has thus far occurred has permitted a greater utilization to be made of such facilities and the merger would in the future completely eliminate any duplication of gathering lines and field compression facilities as well as duplicate field housing facilities and equipment used in field operations.

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Two separate staffs to negotiate contracts, two separate accounting departments to determine expenses, two separate staffs to prepare filings for the Federal Power Commission, these would not have been required and will not be required under merged operation.

I feel we have indicated only a portion of the extent to which benefits accrue to all parties from this merger.

Q. Mr. Steen, does El Paso have any interest in Canadian gas? A. Yes, we do.

Q. Does El Paso have any interest in gas developed or undeveloped along the route of Pacific's pipeline? A. Yes, sir.

Q. Now, how would El Paso propose to make this gas available to its customers? A. Well, there are several ways this could be done. One way would be for El Paso to build a pipeline, if economically justified, to the area in which gas might be produced. Unless substantial volumes of reserves were developed in any given area, this might not be the most economical method of getting such gas into its system.

Another method would be through possible exchange agreements if they could be worked out. Certainly the public would not be served in the most efficient manner by duplication of facilities. Therefore, the most economical and feasible plan would be the

introduction of gas into Pacific's system and a displacement of this gas in El Paso's system under a merged plan of operation and ownership of facilities.

Actually this merger benefits all customers of both systems since all customers would be connected to all sources and all areas served would be given a greater stability of supply.

Q. Mr. Steen, we have already had some testimony with respect to the benefits of flexibility in the operation of the combined systems. Since you are Vice-President in Charge of Operation, I would like for you to comment on this matter and refer specifically to the additional flexibility that would be obtained as you see the situation. A. Well, the matter of flexibility is an extremely important item and one which I feel can be explained in considerable detail.

Before making this explanation, some amount of background is necessary.

At the present time El Paso is certificated to deliver through two points on the California border, namely Topacke and Blythe, a total volume of gas in excess of 2 billion cubic feet per day. Although this gas is usually delivered at a load factor of 91 per cent or greater, from time to time, rather drastic fluctuations occur.

For instance, on any particular day El Paso may be called upon by its California customers to either increase or decrease

the quantities of gas being delivered to them. Deliveries to these customers may vary at certain times in amounts up to several hundred million of cubic feet per day. This situation creates the definite need and requirement of El Paso's system that large volumes of gas be shut off and turned on on relatively short notice.

Operationally this is accomplished by the use of dry gas as a fluctuating supply, and in some instance by the use of storage or pack in the main transmission line.

In order to emphasize the value of flexibility as it relates to El Paso's system in this proposed merger, I would like to refer you to the map that has been used in this case previously. As can be noted, the combined El Paso-Pacific system will have supplies of gas available to it at the northern end of the system near Sumas, at approximately the middle of the system near the Big Piney area and the general San Juan Basin area, and in the Permian Basin at the southern end of the system. Gas produced from Canadian sources, the Big Piney and the San Juan areas, is substantially all dry gas and can be controlled to a great extent by the purchaser, making available large quantities of gas supply or curtailment thereof on reasonably short notice.

Now, let us assume a specific example of how this flexibility may be utilized. Suppose, for example, there is a shortage of gas from Pacific's Canadian source. It would

be necessary that Pacific in some manner make up this supply of gas and it would undoubtedly be done by increasing the movement of gas in a northerly direction through Pacific's pipeline system. Although this would seemingly indicate the necessity of curtailments or shortage to Pacific customers, such curtailment or shortage can be overcome by utilizing the 34-inch pipeline which was described in earlier testimony connecting Pacific's system and the California delivery points near Las Vegas, Nevada.

By reducing the amount of gas being delivered through this proposed Las Vegas line, the volume of gas produced can be utilized in meeting demands of Pacific's customers. Because of the curtailment of gas moving through the Las

Vegas line, it then becomes necessary to utilize El Paso's system in replacing the amount of gas cut off.

Essentially this will be made up by deliveries through El Paso's system at Topack and Blythe delivery points, thereby counteracting the effect of reduction or curtailment through the Las Vegas delivery point. This additional delivery through El Paso's existing delivery points is no great mystery. As I have mentioned before, El Paso's system requires the ability to swing large volumes on very short notice. The gas would be made available by the combination of line pack, the use of spare horsepower, and the utilization of whatever operating flexibility El Paso is able to employ. By using this same

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line of reasoning, curtailments which are felt in the San Juan or Rocky Mountain areas may also be effectively counteracted by use of El Paso's inherent flexibility.

I would like to emphasize at this point that this is not entirely a one way street. El Paso and its customers would derive great benefit from having available gas from Pacific's system during periods of curtailment of gas supply from sources normally feeding El Paso's system. The Las Vegas line will provide an additional source of gas to California, and should El Paso's supply from the San Juan area be interrupted by some major calamity, the Las Vegas line would be used to its maximum capability. This in connection with El Paso's capabilities at Topack and Blythe would make available to California all the gas that could possibly be delivered under any particular set of circumstances.

We have, in effect, by use of this merged operation made available to the benefit of all customers the large amounts of residue gas available from El Paso's holdings in the Permian Basin. This has not been done by any direct connection between the source and the sale but, rather, by

the ability to displace gas in a multitude of directions, to provide for additional supplies at the point where they are most needed at any time. To me this is a factor which can not be overemphasized. Not only can this flexibility be utilized that I have previously stated, but the existing systems lend themselves to the same

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benefit.

At the present time interruption to Pacific's sources in Canada could be counter-balanced to the maximum capability of Pacific's system by moving San Juan Basin gas from El Paso holdings in a northward direction. It is also true that any deficiency in San Juan Basin supplies can be made up by a displacement of gas from the Permian Basin. This displacement is brought out by an increase in takes from the Permian Basin with coincident cut-back in El Paso's San Juan take. This in effect allows more San Juan gas to be used in a northerly direction without reducing the total deliveries required to California. Should El Paso experience a plant or pipeline failure in the San Juan Basin, gas from Pacific's sources could be utilized to the fullest possible extent and Pacific's reduction in San Juan made up from Big Piney and other Rocky Mountain sources along Pacific's system.

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Mr. Kurtz: How many studies did you make concerning these savings? Was it just one or was it several?

The Witness: More than studies, Mr. Kurtz. It was discussions among our groups of supervisors, talking together, and they were instructed to go back and give consideration to this whole problem and come up with their recommendations of what their particular department could do by combination.

Mr. Kurtz: Those are the recommendations that were the basis for your figures?

The Witness: That is correct, sir.

Mr. Kurtz: Are those recommendations in writing?

The Witness: No, sir; they are not. They were in discussions.

Mr. Kurtz: Apparently oral, and they gave you a figure.

The Witness: That is correct.

Mr. Kurtz: And you put the figure down.

The Witness: That is correct.

Mr. Kurtz: And did you make more than one study of that

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type?

The Witness: We discussed it a number of times. We finally came up with one study, however.

Mr. Kurtz: All right.

The Witness: One estimate. Let me put it that way.

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Presiding Examiner: What do you mean when you say "swings", Mr. Steen?

The Witness: Well, when I say "swings", Mr. Examiner, we might be delivering in the system, say, a billion, two hundred million to one customer. They might cut that volume back over a weekend to 800 million.

Presiding Examiner: Or they might increase it.

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The Witness: Yes, sir.

Presiding Examiner: Would you call that a "swing"?

The Witness: Yes, sir; I would, sir; but, generally, the increase would occur after they had cut back; because, if we were delivering at the top rate, it would be hard to

increase and maybe we wouldn't be certificated to do that; but we do swing this system and take the swings or fluctuations in the demands.

Presiding Examiner: Then a "swing" may be either a reduction or increase.

The Witness: Yes, sir.

Presiding Examiner: That is all I wanted to make clear.

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The Witness: Yes, when I mentioned awhile ago the 91 or 92 per cent load factor, Mr. Kurtz, on up to ninety-five or ninety-six, that leaves you five per cent and you are talking about two billion feet of gas and five per cent of two billion is a sizable volume of gas that you would have available from day to day anyway.

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Arnold LaForce

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Direct Examination

By Mr. Shannon:

Q. Please state your name for the record. A. Arnold LaForce.

Q. By whom are you employed, Mr. LaForce? A. I am employed by El Paso Natural Gas Company.

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Q. And what position do you hold with El Paso? A. I am Financial Vice-President of El Paso Natural Gas Company and also a member of the Board of Directors of El Paso Company and Pacific Northwest Pipeline Corporation.

Q. How long have you been employed by El Paso? A. Since April of 1956.

Q. Will you tell us briefly some of your principal duties as Financial Vice-President of the company. A. Well, in general my duties relate to the direction and supervision of the financial operations of the company. I am responsible for the financing programs of the company and the execution of the sales of securities of the company, bonds, and debentures, preferred stock, common stock, in amounts necessary to provide the required funds for the expansion programs of the company.

In addition my responsibilities include the establishing and maintenance of satisfactory lines of credit with the commercial banks, the maintenance of relationships with security holders, and the general investing public, and the investment of the pension fund monies of the company.

Q. Can you tell us something of your previous experience and work before you became associated with El Paso. A. Well, prior to my employment by El Paso Natural Gas Company, I was affiliated with the Metropolitan Life Insurance Company for some 15 years. As a Vice-President of the

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Metropolitan Life I had broad responsibilities in that company's securities investment department. Prior to my affiliation with the Metropolitan Life, I was associated with the New York Stock Exchange firm of Granbery Marache and Company, and also at one time was a professor of finance and investment at the New York University Graduate School of Business.

Q. Did your responsibilities with the Metropolitan Life require you to have detailed knowledge of the operations of natural gas companies? A. Yes, they did. For a considerable number of years while I was at the Metropolitan, I was the lending officer responsible for the making of

recommendations to the Committee on Finance and Investment of the Metropolitan Life with respect to proposed investments in public utility securities, securities of public utility corporations, including natural gas pipeline companies and natural gas distribution companies.

In both absolute and in relative terms, the investments of the Metropolitan Life in the natural gas pipeline industry were greater than those of any other investing institution in the country, and at the time of my resignation in 1956, the aggregate investment of Metropolitan Life in the natural gas industry was in excess of some $500 million.

This natural gas investment portfolio encompassed most of the principal natural gas pipeline companies of the country, including both El Paso and Pacific Northwest. Hence, in the

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supervision of the building up of this portfolio, it was, of course, necessary for me to become as familiar as possible with the various aspects involved in the operation of natural gas pipeline companies.

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Q. Mr. LaForce, were you associated with El Paso at the time the negotiations were entered into with respect to the acquisition of Pacific Northwest common stock by El Paso? A. Yes, I was.

Q. Would you please state the present ownership of Pacific's common stock by El Paso and develop chronologically the steps that were taken in acquiring that ownership? A. Well, at the present date, El Paso owns, to be exact, 2,976,507 shares of Pacific Northwest common stock, and that represents 99.85 per cent of the total 2,991,972 shares outstanding.

The chronological background with respect to this acquisition was approximately as follows:

As Mr. Kayser testified yesterday, with respect to the reasons for this acquisition, the negotiations themselves started in August of 1956, and, as was also testified yesterday, from the outset the officers of Pacific Northwest Pipe Line insisted that the only legal route that they could expect to negotiate on was an exchange of stock, and not through a merger or acquisition of the physical assets.

Well, from August, 1956, on, these negotiations continued, and the result was that on November 8, 1956, there was executed an exchange agreement between El Paso, on the one hand, and Pacific Northwest and ten stockholders of Pacific Northwest, on the other hand, and these ten stockholders of Pacific Northwest

comprised its entire board of directors.

This exchange agreement was identified as Exhibit 2. This stock exchange agreement provided for the exchange of eight shares of Pacific Northwest common stock for seven shares of common "B" stock of El Paso, or in terms of a splitup that was actually voted on at this same meeting at which the exchange offer was put to El Paso stockholders for their authorization, that would be, giving effect to that two for one split, fourteen common "B" shares of El Paso for each eight shares of Pacific Northwest; or, to reduce that further, it is one and three-quarters El Paso "B" shares for one Pacific Northwest share.

After that exchange agreement was signed,—and I also should mention the fact that it provided for a loan of $15 million by El Paso to Pacific Northwest, and that obligation to lend the money was independent of whether the exchange offer was ever made and was independent of whether the exchange offer was ever consummated, and it gave to Pacific Northwest, upon being lent the $15 million, the option to pay the loan in either cash or in

common stock at the rate of $30 a share, or they could pay it by delivering 500,000 shares of Pacific Northwest common stock.

This exchange agreement which provided for the exchange offer, as I have indicated, of seven for eight before the split, was subject to the approval by the El Paso stockholders of such

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proposed exchange offer; and, likewise, the authorization by the El Paso stockholders of the required new common "B" stock.

And, secondly, it was subject to the effectiveness of a registration statement under the Securities Act of 1933, which registered the new common "B" stock which was to be utilized in the making of the exchange offer.

After the signing of the exchange agreement, and in accordance with its terms, we therefore next proceeded to set up the arrangements for a special meeting of the stockholders which was held on December 21, 1956, and which was called by a notice of meeting and an accompanying proxy statement dated November 26, 1956, a copy of which was offered in evidence here as indicated by Mr. Shannon as Exhibit Number 3.

At this special meeting of stockholders on December 21, 1956, the common stockholders of El Paso, by an overwhelming vote of 3,900,000 shares, approximately, voting "yes", and only about 16,000 shares voting "no", approved the making of this exchange offer by El Paso of its common "B" stock for Pacific Northwest common stock. And subsequently, upon the effectiveness of the registration statement, on January 8, 1957, El Paso then did make the exchange offer to all the stockholders of Pacific Northwest.

This exchange offer was almost universally accepted by the Pacific Northwest stockholders and, upon expira-

tion of the offer on May 1st, 1957, El Paso had acquired 2,986,802 shares

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of the common stock of Pacific Northwest.

Some months elapsed after the expiration of that exchange offer, but, as is always the case, there are some stockholders who are in Europe and they forget they have the stock and they come back and they say, "We were out of town; we were away; we would now like to exchange our stock."

So, commencing in the period from December 16, 1957, up to the present time, El Paso has by purchases in the open market acquired an additional 705 shares of Pacific Northwest stock, which results in the above-mentioned or first-mentioned ownership of Pacific Northwest common stock today in the amount of the total of 2,987,507 shares.

Hence, at the present time, there remain outstanding in the hands of the public only 4,465 shares of Pacific Northwest common stock.

Q. Now, Mr. LaForce, would you summarize the essential elements of the proposed plan of merger with particular reference to its effect on the capital structure of each of the companies? A. El Paso proposes to acquire the facilities of Pacific Northwest by merging Pacific Northwest into El Paso, pursuant to Section 253 of the Delaware General Corporation Law. The complete text of that Section 253 of the Delaware statute was identified as Exhibit 4.

Section 253 of the Delaware law authorizes a merger of a subsidiary company into a parent company without the vote

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of the stockholders of either corporation if the parent company owns at least ninety per cent of the outstanding shares of that subsidiary corporation.

Now, today, Pacific Northwest has publicly outstanding 287,000 shares of a $3.30 cumulative preferred stock and, also, 58,000 shares of a $5.60 cumulative preferred stock, and it will therefore be necessary to call these two issues prior to the merger at the respective redemption prices of $60 per share and $104 per share.

After the redemption and cancellation of these two outstanding, now outstanding preferred stock issues of Pacific Northwest, Pacific Northwest would, of course, have left outstanding, as capital stock, only the common stock; and, since El Paso does own in excess of ninety per cent of this issue, the merger of the two companies under Section 253 would then be possible.

The combined aggregate redemption premium for the two preferred issues is $23,252,000, excluding accrued dividends, and a loan of $23,000,000 for this purpose would be made by El Paso to Pacific to provide it with funds to call these two preferred stock issues.

The funds for this purpose would be raised by El Paso by a bank loan in the amount of $23 million, and the balance of the $252,000 required would be obtained from the working funds of Pacific Northwest.

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Q. Mr. LaForce, let me interrupt you. I think you said the combined aggregate redemption premium on the two preferred was some $23 million. A. I meant to say the combined aggregate redemption requirement, which would include the face value of $23,020,000 plus the premium of $232,000. The combined redemption requirement for the two issues.

Q. Right. Now, in order to carry out the merger, would any filing be made with the Secretary of State of Delaware? A. Yes. To legally effect the merger, all that is required is the filing with the Secretary of the State of Delaware of a certificate of ownership and merger, merging Pacific

Northwest Pipeline Corporation into El Paso Natural Gas Company, and a copy of such proposed certificate is set forth here and identified as Exhibit 5.

Upon the legal effecting of the merger, all intercorporate debts between the two corporations would be canceled and El Paso as the surviving corporation would assume all the corporate debts of Pacific Northwest, and all its liabilities, and each share of the common stock of Pacific Northwest that is not owned now by El Paso would be acquired by the exchange of 1¾ shares of El Paso common stock for each share of Pacific Northwest common stock. That is the same ratio, then, that was used in the exchange offer giving effect to the split-up, subject, of course, to the dissenting rights of the remaining publicly held

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stock of Pacific Northwest as provided in the Delaware statute, that is, their right to go and ask for an appraised value for their stock. That would legally, then, complete the merger.

Mr. Kurtz: Just at that point, Mr. LaForce, why is it necessary to redeem the preferred stock of Pacific?

The Witness: Well, it is necessary, first, because the statute says that the parent company has to own 90 per cent of all stock of the subsidiary. The two preferred issues are in the hands of the public and therefore they would have to be eliminated, and the only practical way to eliminate them, since they are scattered all over, is to call them.

Mr. Kurtz: That is the reason why you are going to call them.

The Witness: That is correct.

Mr. Kurtz: Thank you.

By Mr. Shannon:

Q. Mr. LaForce, what is the nature of Pacific Northwest' and El Paso' outstanding debt and in connection with the

assumption by El Paso of the Pacific Northwest debt, will it be necessary to obtain any consent to modifications from the holders thereof? A. Well, excluding intercorporate debt, the long-term debt of Pacific Northwest at December 31, 1957, totalled $200,768,000.

Mr. Kurtz: What was that figure again?

The Witness: Exactly it is $200,760,882.

Mr. Shannon: $768,000.

The Witness: $768,882.

Mr. Kurtz: As of what date?

The Witness: December 31, 1957.

Mr. Kurtz: Thank you.

The Witness: And that was broken down, Mr. Kurtz, as follows: $160,800,000 represented the first mortgage pipeline bonds of Pacific Northwest, and they bear interest rates of 4¼ per cent, 4⅜ per cent, and 5 per cent; and then secondly, there was $33,975,000 of term bank loans of Pacific Northwest outstanding at this date and they bear interest rates of 3½ per cent and 3¾ per cent.

And lastly there was $5,993,882 of miscellaneous debt.

Now, all of this long term debt of Pacific Northwest was placed privately, and that is the debt of Pacific Northwest that we have to deal with in the merger.

Turning to El Paso, the long term debt of El Paso, again excluding intercorporate debt, at this same date, December 31, 1957, totalled $558,529,161, and that was broken down as follows: $460,127,000 of first mortgage pipeline bonds bearing interest rates ranging from 3 per cent to 4½ per cent; and secondly, $31,600,000 of debentures bearing interest rates of 3 per cent and 4¾ per cent; and thirdly, $60,000,000 of convertible 5¼ per cent debentures; and lastly, $6,802,161

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of miscellaneous long term debt.

Mr. Kurtz: Might I have that last figure again?

The Witness: The last one?

Mr. Kurtz: Yes.

The Witness: $6,802,161.

Mr. Kurtz: Thank you.

The Witness: Now, all of the long term debt of El Paso has always been placed privately, except the $60,000,000 of convertible 5¼ per cent debentures, which was sold publicly and underwritten by a syndicate in connection with a rights offering of that issue to the common stockholders of El Paso.

In connection with the assumption of Pacific Northwest's first mortgage pipeline bonds by El Paso, which is what will be affected in the merger, there are two alternative methods that can be employed.

First, in carrying out this assumption of the Pacific Northwest first mortgage pipeline bonds, you might exchange par for par El Paso's bonds of the same maturity date, same sinking fund provisions, and the same interest rate, and you would consequently extinguish the Pacific Northwest mortgage and proceed to do all your financing as in the past for the El Paso company under the El Paso first mortgage indenture as it now exists.

The second method that you might employ to legally assume this debt would be to close the Pacific Northwest mortgage and

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prohibit the issuance of additional bonds under it, and then just assume the obligation to pay those bonds as they mature and as the sinking fund obligation comes about. That would then effect—it would make the Pacific Northwest mortgage a prior lien but no additional bonds could be

issued under that mortgage, and all additional financing would then be done under the El Paso first mortgage indenture which would be made a first and refunding mortgage indenture.

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Now, that second method is much more a complicated procedure to follow in that you would have to close the Pacific mortgage, make it a prior lien, prohibit any financing in the future under it. You would have the question in the event of future additions to the Pacific system of whose lien would attach.

If you had a pipeline going—if you laid another loop line down Pacific's line in the same right-of-way, whose lien would attach? It is the Pacific lien or El Paso lien that attaches? And so forth.

So, in the discussions that we have had with the principal bondholders of El Paso and Pacific, we have indicated that we would prefer to follow the first method, that is, to simply exchange El Paso bonds par for par for the Pacific Northwest bonds of the same maturity, the same sinking fund provisions, and the same interest rate.

Presiding Examiner: Same security?

The Witness: Same security.

Presiding Examiner: Not the total.

The Witness: Their security would be then that of the El Paso over-all system.

Presiding Examiner: That is what I mean.

The Witness: That is right, and the Pacific mortgage would be extinguished.

Presiding Examiner: And the full faith and credit of El Paso would be behind the bonds.

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The Witness: And the full faith and credit would be behind that new issue and it would rank equally with all the

other outstanding series of the company, which have been issued in the past with respect to its first-mortgage bond financing.

Now, fortunately,—and I say "fortunately" because you have got to get consent to this—fortunately, all of the mortgage bonds of each company, the Pacific Northwest company and the El Paso company, are held privately; that is, they were sold at direct placement and in our discussions held with the principal Pacific Northwest bondholders and the principal El Paso mortgage bondholders, they have indicated verbally their preference for the first method; that is, this direct exchange of El Paso bonds for Pacific bonds, and the extinguishing of the Pacific mortgage.

Moreover, the principal bondholders contacted have stated that regardless of the method that might actually be employed—and we certainly expect the former method will be employed—they are willing to grant whatever consents are necessary to consummate the merger.

Now, in the light of these discussions with the principal bondholders of El Paso and Pacific Northwest, I do not anticipate any difficulties under present circumstances in obtaining the necessary consents without any adjustment in interest rates on the various outstanding mortgage bond issues. If the Federal Power Commission authorizes the proposed merger, all required

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consents of bondholders, of course, will be obtained prior to the date of the merger.

Now, turning next to the next category of debt of Pacific, which is the term bank loans, those term bank loans have a provision prohibiting any merger except with the consent of the banks.

We have discussed the proposed merger with each of the

participating banks in this term bank loan of Pacific, and they have indicated their willingness to consent to the merger without any adjustment in the interest rates of those loans.

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The Witness: So, as far as the term bank loans of Pacific, there, too, the holders have said that they will consent to the merger without any adjustment in the interest rates of their loans.

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Q. What financing advantages do you anticipate will result from the consummation of the merger? A. In my opinion the merged company would have distinct advantages in the procurement of capital for expansion. The El Paso company had a long and successful record of profitable operation. Its markets are growing at approximately three times the rate of the rest of the country, and natural gas has been able to compete effectively with other fuels in those markets.

These factors rank foremost in the minds of the long term buyers of the securities of El Paso or any company, institutions and individuals alike, and likewise to the commercial banks who extend large lines of short term credit.

Although all of the mortgage debt of El Paso, as I have indicated, has been placed privately, El Paso does have outstanding an issue of $60 million of convertible 5¼ per cent debentures due 1977, which issue was sold publicly and is rated BAA by Moody's Investor Service. Such a rating for the debenture credit for El Paso implies correctly, I think, that the mortgage bonds of El Paso would be probably rated A by Moody's, since Moody's generally rates the mortgage bonds of a company one notch higher than the

debenture bonds of the company since they are secured bonds as opposed to unsecured bonds.

Now, Moody's states, to quote them, that "Bonds which are rated A possess many favorable investment attributes and are

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to be considered as higher medium grade obligations."

El Paso's established position with the various investing institutions, individuals and commercial banks would in my opinion be reinforced by the merger of the two companies. Although the immediate effect of the merger on El Paso's capital structure on a corporate basis only, or on a non-consolidated basis, would be to increase the ratio of funded debt to total capitalization and surplus from 64 per cent to 69 per cent, it should be recognized that beginning with the second quarter of 1957 El Paso has been rendering financial reports to security holders on a consolidated basis, including Pacific Northwest Pipeline's balance sheet and income statement.

Hence, the financial statements issued since the second quarter of 1957 have reflected therein the impact of Pacific Northwest's higher debt ratio and its poorer earnings experience. In other words, what I am saying is that I believe the terms that El Paso has been able to negotiate in the sale of its securities during the approximate past year and a half have been more or less completely reflected —have more or less completely reflected the inclusion of Pacific Northwest in its financial picture or in the over-all operations of El Paso.

In other words, and to re-emphasize that, what I mean is that these consolidated statements are issued to security

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holders. They are available to the general public. Your debt ratios, your equity ratios, your coverage of interest

charges, and so forth, are all based upon this consolidate
presentation that El Paso has made.

On the other hand, since the date of the antitrust sui
it is also true that the investing community has recognize
the uncertain control which El Paso exercises with respe
to Pacific Northwest. In view of this uncertain contro
investors necessarily have had to question whether E
Paso will be allowed the opportunity to attempt to achiev
the benefits and advantages it expects to obtain from me
ger of Pacific Northwest as were outlined in the testimon
of Mr. Kayser, Mr. Silloway, and Mr. Steen.

These doubts that investors now have would, of course
be removed if the merger was authorized by the Federa
Power Commission. As a result of the merger El Paso'
financing position undoubtely would be improved by vir
tue of the operational flexibility and economies resulting
therefrom, and most important, by the then definite
assurance of a substantially strengthened gas reserve
position. Gas supply is certainly one of the most im
portant factors weighed by potential investors in their
consideration of natural gas pipeline securities for invest
ment, and determines to a substantial degree the terms of
the securities sold.

For example, in the case of a debt issue, the nature and

adequacies of the company's gas supply will have a direct
bearing on such terms as the interest rate, the sinking
fund provision, and the maturity. The consummation of
the merger will strengthen greatly the long term gas supply
picture of El Paso as well as decrease its relative depend-
ence on residue gas. Hence, El Paso, among other things,
will be enabled to lengthen the maturities of its future
debt issues and thus reduce the annual sinking fund re-
quirements on these new issues that it will issue in the fu-
ture.

Such a reduction in the annual cash requirement of the company will, of course, be of substantial benefit to it.

Turning to Pacific Northwest, it has already been testified that Pacific Northwest experienced a net loss from operations in the year 1957 of $2,067,000, and Mr. Silloway also stated, in response to your question, Mr. Kurtz, that it was expected that the net loss from operations in 1958 would be in the neighborhood of $1.5 million.

Now, in view of the present financial position of Pacific Northwest, it is imperative from the viewpoint of economical financing in the immediate period ahead that a decision be made as soon as possible to merge Pacific Northwest and El Paso so that any property additions to the original Pacific Northwest system can be financed directly by the El Paso Company and not by Pacific as a separate corporation.

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All of the outstanding debt, as I have stated, of Pacific, is held privately. None of it has been sold publicly; and, therefore, no ratings of its debt by investment services such as Moody's are available. However, it is my opinion that serious difficulties would be encountered if an attempt was made today to finance Pacific Northwest as a separate corporation.

Thus I feel, if such an attempt was made, that potential investors would raise questions concerning the future profitability of Pacific Northwest as a separate corporation based on its presently certificated markets.

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Q. Mr. LaForce, you have mentioned the raising of debt capital.

Does that involve any problem with respect to raising of equity capital? A. Yes, it most certainly does; because

I think in this connection it has to be recognized that the ability of any company to raise additional senior capital rests in turn upon its continued ability to raise equity capital.

In my opinion under present conditions, Pacific Northwest alone, without El Paso, would find it most difficult

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to raise equity capital for expansion on reasonable terms, thus affecting its ability to raise, in turn, additional senior capital.

I think we have to recognize that the huge investment represented by a pipeline system makes the cost of capital a particularly important factor in rates to consumers.

The merged company will be able to raise new capital at lower cost and such savings, of course, will redound to the advantage of the consumer.

Most important, however, from the consumer's standpoint is the assurance that the needed expansion of pipeline facilities can and will be financed.

Q. What dollar savings and financing cost would you expect to result from the consummation merger? A. Well, in response to your last question, I set forth the reasons why I believe that substantially more advantageous terms of financing could be obtained by the merged company over those that could be obtained by Pacific Northwest as a separate corporation.

But assuming in some manner Pacific Northwest would be able to raise equity capital today, which in turn would make possible the raising of senior capital, the cost of such new capital in my opinion would be high and substantially more than the alternative cost if such capital was raised by El Paso after merging Pacific Northwest.

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The exact pinpointing of such a cost differential is, of course, impossible; but, certainly, it would be substantial in each category of capitalization; that is, in the interest rates you would pay on debt issues, on the dividend rates you would have to pay on preferred stock issues, and in the cost of raising new common stock money.

However, aside from this question, that is, the cost of raising new money, there are, of course, definite dollar savings that would be realized as a result of the fact that one corporation would be raising capital instead of two corporations.

For example, we have made a study that assumed a sale by El Paso of $50 million of first-mortgage pipeline bonds in a given year, as opposed to a separate sale of $25 million of mortgage bonds by El Paso and $25 million of mortgage bonds by Pacific.

On the one hand, what we did was this:

We took $50 million of first mortgage bonds of El Paso and we assumed we would sell them in a given year.

In addition—we assumed that the merger had been consummated and all financing would be done under the El Paso mortgage indenture.

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Now, as opposed to that, if you continue to operate Pacific as a subsidiary and had to do mortgage bond financing for it, as well as mortgage bond financing for El Paso, we would assume that in a given year you might sell $25 million of El Paso bonds and $25 million of Pacific bonds, or two separate issues of $25 million by each company as opposed to the $50 million of El Paso alone.

On the other hand, now, in making that comparison we found that by doing it just as one El Paso issue—and I have the details broken down if anyone wants to see them—

that the dollar savings by having El Paso do all that mortgage financing instead of a combined sale by the two companies would be $118,000 in the case of a public sale, and $52,000 if the issue was sold privately or through direct placement.

Such savings are related to primarily such things as attorneys' fees, printing costs, I saw some shuddering there—attorneys' fees, printing costs, accounting fees and engineering fees. I also believe that similar savings would be realized in equity financing as well as debt financing.

In conclusion I feel that a very conservative estimate—and I believe it would be higher—but a very conservative estimate of the annual savings that would be realized from this source over the next few years if the merger was consummated would be at least $50,000 per year.

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Mr. Kurtz: Well, when you mentioned tax, you mentioned something about the reasons for the acquisition of stock; Pacific insisted upon that. That was because the stockholders of Pacific would have not to pay income tax upon it, isn't that right?

The Witness: Well, that is something separate, I believe, Mr. Kurtz.

Mr. Kurtz: Wasn't that one of the things that was

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discussed at these various meetings?

The Witness: Well, if you mean, it had to be a tax free exchange, yes. Is that what you mean?

Mr. Kurtz: Yes.

The Witness: We had to get 80 per cent of the Pacific Northwest stockholders to agree to the exchange so that the exchange itself would not result in any tax to them. It would have to be a tax free exchange.

Mr. Kurtz: I see. Well, you used the phrase that I was searching for, sir. If there was this security acquisition of facilities, would it be a tax-free exchange?

The Witness: Yes. Your Internal Revenue code provides that in the case of a merger, that that, too, is a tax-free exchange.

Mr. Kurtz: You mean where there is direct purchase of facilities.

The Witness: Yes, involving, as most mergers do, also an exchange of stock. It would be a tax-free exchange also.

Mr. Kurtz: Now, you have mentioned about the transfer of this stock. What price did El Paso actually pay for Pacific's properties?

The Witness: Well, in that situation, Mr. Kurtz, you have to go back, I think, to consider all the factors that enter into the determination of an exchange offer. Whenever you combine companies, there are certain objective facts that are

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gathered by each of the negotiating parties, such as the comparative market value of each stock, the comparative book value of each stock, the investments of each company, the extent and location of its assets, the extent, in our case, and location of the reserves, the comparative tax position of each company, and the potential earnings outlook for each company.

All those objective facts are weighed by each of the negotiating parties.

You then enter into a trading negotiation, and by the exercise of judgment you arrive at an exchange offer which you believe to be a fair one.

Now, in the case of our offer we were offering, first of all, a B stock that was different than our regular common in one sense, that dividends on it did not commence until January 1, 1958, and the reason for that was, as I have

stated, Pacific Northwest was in a process of physically completing its line. It was not expected that earnings would be realized until 1958. So that provision was made.

So in a sense we have to recognize at the beginning that the B stock was in that respect, at least, different from the regular common.

Now, as to the amount, the market value of the El Paso stock that we were offering, if you refer to the proxy statement there in which we submitted this proposed offer to our own stockholders for their authorization, we stated there that the

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market value as computed, estimated for this El Paso stock we were offering, was approximately $140 million. Now, I would emphasize, however, that some part of that market value was for investments of Pacific Northwest. Some of it was for the pipeline. In that proxy statement you will see indicated there that the investments of Pacific Northwest at that date were valued at approximately in the market-place $77 million. So when you say how much do we pay for it, we paid $140 million of estimated market value for a pipeline and reserves of Pacific on one hand and we paid that also for investments of Pacific Northwest that had this market value of $77 million.

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Mr. Kurtz: Yes, I have a couple of clarifying questions.

Mr. LaForce, in your Exhibit 2, there is attached Pacific Northwest Pipeline Corporation and wholly-owned subsidiary companies' consolidated balance sheet as of August 31st, 1956, and it shows under the liabilities, under the equity capital, as of this date, $24,208,532.

Now, is that the figure, that equity capital, that could

be used in relationship to the $140 million paid if we were to determine the net assets?

I want to know if I have the right balance sheet.

The Witness: Yes, I think this is the proper balance sheet to use. You might also use the one that is in the proxy statement, but this is the one the exchange agreement was made

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on; yes.

Well, yes, that is in a sense true, Mr. Kurtz. I stated we were in effect offering El Paso's stock with a market value of $140 million for the capital stock, for common stock of Pacific Northwest, which is shown there, as you have indicated, at a book value of $24,200,000; but to be perfectly sure we understand what we were getting for it, I would like to also turn you over to the asset side of that balance sheet and to point out that although that is book value, which is the base of all financial statements, over there on the asset side it shows investments in associated companies at cost of $13,800,000.

Now, those investments had a market value of $78 million.

Let's not confuse market value with book value alone. That is the market value of the El Paso stock we gave for Pacific stock.

Mr. Kurtz: So what you are saying is that if you were to take the $24 million and add to it the $13 million shown on the asset side, and that is what you have got to buy?

The Witness: Yes.

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Mr. Kurtz: Yes, you thought it was a prudent investment?

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The Witness: That is right.

Of course, I will emphasize too that as far as the $140

of market value we paid, that our accounting treatment in no way involved affecting the rate base that we were acquiring.

There was no write-up. We did discuss the accounting aspect of this whole acquisition at quite some length and our original expectation, as I remember it, was that we would, on El Paso's balance sheet, show the investment in Pacific Northwest stock at cost to us, or at the market value. But the more we thought about it and the more we talked to accountants and Mr. Reynolds of Main & Company, our auditors and I went down, if I remember, and talked to Mr. Barr of the SEC and also Mr. Rainwater, the Chief Accountant of the FPC on this matter—the more we thought about it, we thought we should use the "pooling of interest" accounting method which, in effect, meant all we did was to show in our balance sheet the investment in Pacific stock at its underlying book value. So that is the accounting method that was used eventually.

Mr. Kurtz: And that is what you propose here?

The Witness: And that is what we propose here.

I mean, we are not attempting to earn on the market value of the El Paso stock that we issued in exchange for Pacific stock. We are keeping the same rate base and we expect to earn only on the rate base of Pacific as we got it as a result of this acquisition, and eventually we hope, as a result of the merger.

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L. Emery Katzenbach, II

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Direct Examination

By Mr. Shannon:

Q. Please state your name and residence. A. My name is L. Emery Katzenbach, II, and I reside in New Canaan, Connecticut.

Q. What is your occupation, Mr. Katzenbach? A. I am an Investment Banker.

Q. How long have you been an Investment Banker? A. Since 1935.

Q. And with whom are you associated? A. I am presently and have been associated since January 1941 with the Investment Banking Firm of White, Weld & Company, 20 Broad Street, New York. I have been a general partner of White, Weld & Company since 1950.

Q. Would you state in what phase of White, Weld & Company's business you have been most active? A. Most of my time since 1941 has been spent on corporate financing with particular emphasis since 1946 on the financing of natural gas pipelines.

Q. Would you state some of the natural gas pipeline financings in which you have been active?

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A. White, Weld & Company has acted as investment banker for a number of the natural gas pipelines, and in each of these I have actively participated in the financing arrangements.

For example, in addition to the financings for El Paso Natural Gas and Pacific Northwest Pipeline Corporation, I have participated in the initial financing for Transcontinental Gas Pipeline Corporation and each of it's subsequent financings.

I have also participated in the financing of Texas-Illinois Gas Pipeline Company, and in a large number of the financings of Tennessee Gas Transmission Company in which White, Weld & Company have acted as co-manager.

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Q. Would you briefly describe the history of Pacific Northwest's financing programs?

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A. The proceeds of the second financing program were applied to the following purposes: First, the step-up in the first year design capacity from 293,000 Mcf per day to 343,000 Mcf per day; second, the substitution of larger diameter pipe at the northern end of the line and extension of the system to receive the Canadian gas; third, provision for new extensions not previously contemplated or authorized; fourth, to cover increases in costs over these originally estimated; and fifth, to provide funds, totalling about $7,100,000, for the purchase of a 25 per cent interest in the common stock of Westcoast Transmission and a 49 per cent interest in the common stock of Phillips Pacific Chemical Company, Ltd.

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Q. Did those contracts which did contain minimum bill provisions provide sufficient revenues to cover estimated expenses and debt service requirements either at the time of the original financing or the second financing?

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A. No, they did not fully cover those requirements.

Q. Is it true, then, that purchasers of the company's debt securities and underwriters were required to rely primarily on forecasts of revenues, expenses, and earnings as a basis for determining the economic soundness of the project? A. Yes, that is correct.

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A. Pacific's third financing program was consummated in the spring of 1957 for the purpose of completing certain items of construction, financing for which had been intentionally deferred, and for defraying higher costs than those

originally estimated for the completion of the project as a whole. The plans for this third financing program involving a total of approximately $50 million were preliminarily under discussion between the officials of Pacific and of our firm, White Weld and Company, in the summer and early fall of 1956, prior to the time when agreement was reached between El Paso and Pacific on El Paso's offer to acquire the common stock of Pacific in exchange for shares of its own common stock. The plan of financing for Pacific, which had then been formulated, involved the sale of $35 million of additional first mortgage bonds and approximately $15 million of additional common stock. In

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connection with El Paso's offer of exchange of its common stock for the common stock of Pacific Northwest, El Paso agreed to provide the $15 million of funds which were to have been raised by Pacific through the sale of its common stock by making a loan to Pacific in the amount of $15 million and then giving Pacific Northwest the right either to pay such loan in cash or to deliver 500,000 shares of its own common stock, that is, Pacific's common stock, in satisfaction of the loan. This arrangement assured Pacific of obtaining this portion of its required financing whether or not the exchange offer was ultimately approved by the required percentage of Pacific Northwest's holders, and in effect, also assured Pacific Northwest of receiving a price of at least $30 a share for its common stock to the extent required to raise the $15 million.

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Q. In your opinion, did the fact that El Paso had made its offer for the common stock of Pacific have any bearing, favorable or otherwise, on the terms which your firm was

able to negotiate for the sale of Pacific's 1957 bond issue? A. Yes. In my opinion, the fact that El Paso had made this offer had a distinctly favorable influence on the terms which were negotiated for the sale of Pacific's $35 million bond issue.

Q. Would you please give your reasons for that statement? A. Pacific Northwest had commenced operations as of January 1, 1957, although prior to that date there had been certain partial deliveries.

Accordingly, at the time the negotiations for the sale of Pacific's bonds were commenced with institutional investors—I am referring to this latest sale—there was still no operating history or record of earnings. Forecasts of sales volumes and estimates of earnings for 1957 and subsequent years

were therefore the only financial data on which to judge the prospective earnings coverage of the company's interest and sinking fund obligations.

The estimate of earnings which was prepared in January, 1957, showed an estimated net loss of about $2,200,000 for the year 1957, as compared with an estimated net income of about $3,300,000, made approximately one year earlier when Pacific's second financing was undertaken.

This downward revision in earnings for the initial year of operations was definitely a disquieting factor to the institutions which had bought the previous issues of Pacific Northwest bonds, and which were being asked to buy additional bonds in 1957.

Even though the projected loss for 1957 did give rise to a certain amount of questions concerning Pacific's immediate financial strength, the company's long-term potential remained highly promising.

For example, the January, 1957, estimate of earnings for the year 1958 was approximately $6,300,000, as com-

pared with an estimated income for 1958 of about $5,900,000, as per forecasts which were made a year earlier.

In the light of the immediate earnings outlook, as it appeared early in 1957, I found in talking with the officers of financial institutions that were prospective purchasers of Pacific's bonds, considerable interest in El Paso's proposal

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to acquire the stock of Pacific Northwest, and there is no question in my mind whatsoever but what these institutions considered the bonds of Pacific far more desirable for investment with Pacific as a subsidiary of El Paso rather than as an independent company.

Q. Was it proposed at any time that Pacific's bonds be in any way guaranteed by El Paso? A. No; no such guarantee was ever proposed.

Q. Why, then, in your opinion, did these institutions consider that Pacific's bonds would be more attractive for investment with Pacific as a subsidiary of El Paso rather than as an independent company? A. El Paso has been held and, of course, continues to be held in high esteem by its bondholders and by investors, generally, as a credit risk and as a very capably managed company with a good past record.

Pacific, on the other hand, was, at the time, just commencing operations. Its prospects were favorably regarded but, as I mentioned a moment ago, its immediate earnings outlook was disappointing in that a net loss was estimated for 1957.

Bondholders felt that El Paso would not only be financially able but would have every incentive to take responsibility for and render financial assistance to Pacific Northwest as its subsidiary in case unforeseen events should further

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prolong the time when Pacific could achieve its potentially strong financial footing.

Thus, these investors felt far more favorably disposed toward investing in Pacific, Pacific's issue of additional bonds with the financially sound El Paso as Pacific's prospective parent.

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Q. If Pacific were to undertake a financing program at this time to finance additional facilities, would you expect that such financing could be accomplished on terms relatively more favorable or less favorable than those prevailing in the early part of 1957 when negotiations for the sale of Pacific's third series of first mortgage bonds were conducted?

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Now in answering this question you may assume that Pacific remains a subsidiary of El Paso without any divorcement. A. In my opinion Pacific Northwest would not now be able to finance on terms relatively as favorable as was the case in early 1957.

Q. Would you please state your reasons for that conclusion? A. I am advised, and it has been brought out in earlier testimony here, that Pacific Northwest will show results for 1958 which are still unsatisfactory, even though an improvement over those for 1957. Thus we have to look further into the future to visualize Pacific's earning its full rate of return. It will be recalled that in 1957 Pacific Northwest arranged for $15 million of equity financing from El Paso as part of the program in which it sold $35 million of first mortgage bonds.

At the present time I feel that any additional financing program would require a much larger proportion of equity,

that is, common stock, to debt, in order to enable Pacific to sell additional bonds on terms comparable to those obtained in 1957. In fact, I believe that on the basis of Pacific's presently certificated markets, it would be very difficult for Pacific to sell any additional bonds until it has begun to demonstrate a more satisfactory earnings capacity.

Q. Now, if Pacific were to be divorced from El Paso and were now an independent concern, would Pacific now be able to finance on satisfactory terms?

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A. No.

Q. Under the same assumption could Pacific finance a further expansion project on any kind of terms? A. Well, I am not prepared to say that Pacific, cast out on its own, could not now accomplish any financing whatsoever. The company's future is favorably regarded and its present problems are generally regarded as being more or less temporary.

Under such conditions a way can usually be found to finance these capital requirements. In my opinion the company's immediate ability to sell additional bonds would be impaired practically to the vanishing point. Probably some kind of subordinated convertible debenture might be contrived with a conversion privilege and other terms attractive enough to make them salable, but in any event, the assumed circumstances would present Pacific with difficult financing problems that would be relatively costly to overcome.

Q. If El Paso were to acquire the assets of Pacific by merger, would the terms upon which El Paso could finance the combined operations of the two existing systems be more favorable than those under which Pacific might expect to finance its own requirements as a subsidiary of El Paso? A. Definitely yes, in my opinion.

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Q. Would you state your reasons for that conclusion? A. My reasons are simply that El Paso, as I stated earlier, has an excellent credit rating as it now exists. In

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acquiring the assets of Pacific Northwest, it would not be assuming additional obligations. However, it would, in acquiring an immediately profitable enterprise and would be my opinion—and I believe in the opinion of investors generally—be strengthening its longer term position by thus forming an enterprise with what would be regarded as an improved long term gas supply situation, and a good prospect of being able to earn a satisfactory return on the facilities now owned by Pacific Northwest as well as on its own existing facilities.

Q. Assuming again that El Paso acquires the assets of Pacific by merger, is it your opinion that the terms on which El Paso might be able to finance expansion of the combined systems would be any less favorable than the terms upon which El Paso as it now exists can finance its own requirements? A. I believe that the acquisition by El Paso of the assets of Pacific Northwest would tend to have a favorable near term effect on the terms on which it could then finance as compared with El Paso's present position.

From a longer term standpoint I believe that the acquisition by El Paso of the assets of Pacific Northwest would result in an enterprise which would be able to finance on distinctly more favorable terms than is likely to be the case in the absence of a merger.

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Q. Would you please state your reasons for that conclusion? A. As I stated before, I am of the opinion, and I believe investors generally are of the opinion, that a merger of the two systems would substantially enhance El Paso's over-all gas supply picture.

Gas supply is a matter of prime importance to investors, not only purchasers of debt securities but also of equity issues, and it would be my opinion that the combined systems would have a greater degree of operating flexibility and diversification of markets.

All of these factors would serve to enhance the financial standing of the enterprise by comparison with the already excellent position in this respect now held by El Paso.

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The Witness: I believe, and I think investors generally

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believe, that Pacific Northwest, which is not now earning a satisfactory rate of return—in fact, it is incurring losses—faces an ultimate prospect of being able to earn a satisfactory rate of return. I believe that, as brought out in the testimony here, with Pacific, as a division of El Paso, that can be brought about far more quickly than could be the case with Pacific Northwest as a separate company with no affiliation with El Paso.

One of the difficulties would be financing itself through its present problems. As I explained before, it would have difficulty. I think it could be done on a minimum kind of a basis with a certain amount of financing, and in effect it could limp along and perhaps in time achieve a profitable status. But on its own it would have difficulty.

Now, I think I reflect the view of investors, in fact, we are talking to them all the time, they are raising questions with us. They are asking our advice. They are giving us their views and such, and so I think I reflect fairly the investment opinion on the situation, namely, that they are not concerned about the situation with Pacific Northwest now as a part of the El Paso system because of the benefits that El Paso can bring immediately and because from a

financing standpoint the immediate problems are in effect not present. They vanish. So that it is really two separate situations. There are two separate situations in considering Pacific's system as a part

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of El Paso, and in considering Pacific cast out on its own, as it were, as a separate company facing its immediate problems.

Mr. Kurtz: What benefits do you have in mind that El Paso can bring to Pacific immediately? You yourself?

The Witness: Well, I think that I can speak primarily from the financial angle and not from an operating angle. And I think the financial aspects of it are considerable in that, as has been testified earlier in these proceedings, one thing that Pacific needs is to attach additional markets to its system by fanning out connections.

Now, financing those connections is something which El Paso, looking down the road, can justifiably do. It has already testified its willingness and its intention to do so. And it can do so on favorable terms.

Returning back to Mr. Silloway's testimony, however, if Pacific Northwest were an independent company on its own, it would have to be very parsimonious, to use his word, in authorizing capital expenditures of the type that is going to bring in new business because they can't afford to do it, and what is more, it runs into problems in its drilling campaign, as he testified earlier, and from my familiarity with the system I certainly subscribe to his testimony and to the testimony of Mr. Kayser on that point.

Looking at it from the investor's point of view, it certainly makes a lot of sense, and on that basis the terms on which it can be financed are obviously far more favorable.

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Mr. Kurtz: And those benefits were something about a drilling campaign and attaching additional markets.

The Witness: I believe I said that among the benefits would be an improved ability to finance these capital expenditures.

Mr. Kurtz: All right.

The Witness: Now, amongst those capital expenditures are those which are required to be made in the drilling of wells, and to the extent that you are cramped in your financing, one or the other has to suffer: the wells or your laterals to attach new customers; and so you might say they are related in that sense.

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Charles H. Gueffroy

Direct Examination

By Mr. Wolf:

Q. Will you please state your name. A. Charles H. Gueffroy.

Q. Are you President of Northwest Natural Gas Company? A. I am.

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Q. How long have you been connected with the Northwest Natural Gas Company, Mr. Gueffroy? A. It will be 39 years next month.

Q. Are you currently and have you been active in gas industry trade associations and their activities? A. Yes. I have been Director of the American Gas Association for I think about six years. I just finished service of one year as President of the Pacific Coast Gas Association, and I am now a director of that Association.

Q. Would you describe briefly the business of the Northwest Natural Gas Company. A. Northwest Natural Gas Company is the sole distributor of natural gas in Portland, Oregon, Vancouver, Washington, and 83 other communities located in the States of Oregon and Washington.

Until July 1, 1958, the company was known as Portland Gas and Coke Company, its name having been changed to Northwest Natural Gas Company on July 1 of this year. The company has been continuously engaged in the business of distributing gas in communities located in northwestern Oregon and southwestern Washington for many years and will observe its centennial in January 1959.

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Q. With what fuels is the company competitive in its gas distribution business, Mr. Gueffroy? A. We compete with oils refined in the Pacific Coast refineries located in the State of Washington on down as far south as Los Angeles, moving into our franchise area by tanker.

In addition to domestic heating oils, we compete daily with heavy fuel oils in our service to the industrial market.

Additionally, we compete with low-cost hydroelectric power generated in part at Government projects located at Bonneville, Grand Coulee, and other dam locations.

Q. Prior to the introduction of natural gas in the State of Oregon and Washington where you serve, were you able to compete successfully in the fuels market? A. If by "successfully" you mean were we able to stay in business and earn enough money to pay interest on our bonded indebtedness and limited dividends to our stockholders, we were.

However, the dividends were most modest and our ability to attract capital so as to expand the area of our competition was materially limited so long as we were distributing manufactured gas.

With the advent of natural gas, we have been able to compete more aggressively for a larger and a more significant portion of the large fuel market in Oregon and Washington.

Our sales for domestic consumption have increased

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more than 32 per cent since the introduction of natural gas. Our sales at the industrial level are practically all entirely new.

At the time natural gas was introduced, we filed rate reductions which reduced the cost to the residential and commercial consumers an average of seventeen per cent below the cost of manufactured gas. These lower rates have been maintained in the face of an increase in the cost of firm natural gas in February of this year occasioned by the rate increase application filed by Pacific Northwest in August of 1957, at Docket Number G-13202. We reluctantly absorbed this rate increase along with increasing costs of labor, materials, and other supplies.

Q. Is it fair to say, Mr. Gueffroy, that natural gas has enabled your company to compete more effectively in the fuels market and to provide the ultimate consumer with a better and cheaper service? A. It is. And I expected that this would be the case.

As early as 1948, I was actively engaged in attempting to secure a supply of natural gas for the Pacific Northwest.

Originally, we supported the early proposal of Mr. Faison Dixon and his associates to bring natural gas to the States of Washington and Oregon from the prolific gas fields in southern Alberta. Later, when Mr. Dixon was unable to obtain an export permit, we supported vigorously the proposal

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of West Coast Transmission Company, Ltd., to bring natural gas to the same Pacific Northwest area from the

large and expanding gas fields in the Peace River area of northern British Columbia, and northern Alberta, at substantially the same border price.

When the Federal Power Commission rejected the proposal to introduce Canadian gas into the United States Pacific Northwest and, instead, certificated the 1,400-mile pipeline running from San Juan Basin area of New Mexico, Colorado, Utah, and Arizona to the States of Oregon and Washington, we stated we would contract with Pacific Northwest Pipe Line company for a supply of gas limited to what we then estimated to be our requirements based on what we believed would be a higher cost for the gas than estimated by the pipeline company.

Subsequently, when Pacific Northwest itself concluded an arrangement to obtain a supply of Canadian gas at a fixed price for a period of twenty years, we vigorously supported that application because of the increased volume of gas which we believed would become available at prices which would enable us to sell the gas readily.

In connection with that project, and because it contemplated the introduction of Canadian supplies closer to our market, we were able to and we did project larger requirements and demands for gas than would otherwise have been possible were Pacific Northwest to be required to rely solely upon a smaller capacity line and upon the United States sources in

the relatively limited quantities available to the company.

Q. Mr. Gueffroy, is it accurate to say that your company then did not support the Pacific Northwest project in its original inception? A. That is a fact.

Q. Why didn't you? A. As I indicated a few moments ago, my company has been interested in obtaining natural gas even before 1950. Repeated studies made both by

people in our own organization as well as by experts in top-grade engineering consultant firms convinced us that both in terms of adequacy of supply and price, Portland and environs should obtain its gas supply from the prolific Canadian fields located north of the border and closer to our markets.

I was convinced that if Portland was to receive its supply from the distant United States sources of the San Juan Basin area, it would only be a question of time, and I felt a very short time before we would have to deal with rate increases proposed by the supplier.

My concern turned into a reality quicker than even I anticipated. Literally before Pacific Northwest got into full operation, the company filed an application for an increase in its rates and its charges for both domestic and industrial service.

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Q. What is the position of Northwest Natural with respect to the applications which have been filed by El Paso and Pacific Northwest? A. The position of Northwest Natural Gas Company is that the Federal Power Commission should grant El Paso and Pacific Northwest the authority they seek in these proceedings. This position is, of course, subject to the qualification that grant of the authority sought will not in and of itself be used as a basis upon which the resulting combined company will seek to increase the rates now charged distributors in the Pacific northwest.

Q. What are your reasons for this position? A. The basic reason is rooted in a fundamental fact of the economics of the natural gas business. Markets can expand and grow only if a supply is available. Supply in turn is a function of the demand for gas and the ability of the

pipeline transporter to finance the cost of expansion. I testified at several earlier hearings that I believe the original Pacific Northwest pipeline was ill-conceived. Even as the line now stands, with a supply of Canadian gas there

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are portions of the line where practically no market exists, and as a result, utilization of the line is much too low to be economical. I believe the line can be changed into a feasible project by utilizing portions of the line to provide an additional supply of gas for California markets, as I understand El Paso proposes to do.

I do not believe Pacific Northwest as it stands today can readily command the financial support necessary to enable it to expand as it should either in the State of Oregon or the State of Washington, or to the California markets. Additionally I believe a company which has been compelled to sell some of its assets in order to meet its financial obligations is not in a healthy condition. In other words, Northwest Natural's supplier at this stage of the game is not what I would call a healthy supplier. It is to the best interests of the consumers served by my company as well as to the best interests of the stockholders of my company that we have a healthy supplier.

Because the combined company, I mean the company that will result from El Paso's acquisition of Pacific Northwest's facilities, will have a sounder and greater financial strength than Pacific Northwest now enjoys, and because there will be inevitable economies of operation arising from the combined operation, I believe we will have a strong and healthier supplier.

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This in my judgment is a material benefit to the ultimate consumers served by my company.

Q. Mr. Gueffroy, have you any specific reasons to believe that your company, Northwest Natural, would be able to expand the more rapidly and the more efficiently under the operation of the combined company than under the continued single operation of Pacific Northwest? A. I have what I believe is a concrete demonstration of that fact.

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Q. Will you please explain? A. My company has recently acquired the distribution properties in the city of Eugene, Oregon, a large community of 85,000 people lying 120 miles south of Portland, up the valley of the Willamette River, 40 miles beyond our present system.

Between the terminus of our system and Eugene are several communities which, like Eugene, are now without natural gas service.

Additionally, along the route of our existing line from Portland to Corvallis, there is a large volume of industrial business which we are not now able to serve because of lack of capacity in our present facility. It will cost, at present estimates, some six million to eight million to build a new line up the Willamette Valley.

There is serious doubt in my mind that Pacific Northwest can obtain the funds to construct this line.

Up to this point they have not offered to do so. If the applications presently pending before this Commission are granted, I have been advised by Mr. Kayser, President of El Paso, that he will forthwith seek the required certificate from the Federal Power Commission to authorize the construction of a proposed line to Eugene, and that he will build the line.

In short, the financial position of the combined company is such that it can promptly provide facilities and service that will enable my company to expand its operation

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make the industrial sales, whether
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tural gas service are so important
of both the pipeline and the dis-
tion.
ng that it is the intention of the
bined company to make available
enable distributors to make indus-
ed period of time.
bined company will have behind it
gerial competence of the El Paso
with Mr. Kayser and including his

is no small asset. The record of
tantial and is well known to all.

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experiences that kind of success
ial talent of the highest order. I
age of the Northwest Natural and
ves to have that asset working for

Q. Mr. Gueffroy, does your company operate subject to the jurisdiction of any state regulatory commissions? A. We do.

Our Oregon operations are subject to the jurisdiction of the Public Utility Commissioner of Oregon, and our Washington operations are regulated by the Washington Public Service Commission.

Q. Have you advised either or both of these State commissions of your position with respect to the matters which are the subject of these proceedings? A. I have. I have made clear to both of them my strong support for and endorsement of the proposed acquisition. I have explained the reasons for my position to them fully.

Q. Do you have anything further to add to your testimony at this time? A. For the reasons stated, I urge the Commission to approve the application of El Paso and Pacific at Docket Numbers G-13018 and G-13019.

As I have already indicated, in my judgment, the public interest of the consumers of the Pacific Northwest is best served by having their gas needs met from the prolific reserves

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now known to exist in western Canada. I think the existing contract between West Coast Transmission Company and Pacific Northwest is an extremely valuable asset to the consumers of gas in the States of Washington and Oregon. I hope that nothing will be done in this proceeding or otherwise to jeopardize the status of that contract or the benefits flowing from it.

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Paul Kayser

was recalled as a witness and, having been previously duly sworn, was examined and testified further as follows:

Direct Examination—resumed

By Mr. Shannon :

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Q. Turning now, Mr. Kayser, to the State of California, to your knowledge did Pacific Northwest at any time attempt to sell gas in California? A. Oh, yes, the Pacific Northwest negotiated with California Edison and with Pacific Gas & Electric Company with the view of selling them Canadian gas, to my knowledge.

Q. Do you recall when that was? A. That was in '56—yes.

Q. Did the existence of Pacific Northwest and the fact of its attempt to sell gas to Southern California Edison Company have any effect upon the terms upon which you offered to sell gas, or the nature of the service which you offered to furnish to Edison? A. No, it did not, but—

Q. Will you explain your answer? A. Yes. I do not like to make a categorical answer to that without explanation.

In my testimony yesterday I believe I referred to the fact that we have pending an application to sell Southern California Edison 100 million feet of gas a day, to be delivered to the Southern California Gas Company at Topock, and they through their lines are to make delivery to the plants of California Edison. The Docket Number of that is G-12580.

We did that at the solicitation of the Edison

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Company sometime in the very early part of '56, I believe it was.

I received a call from a representative of the Southern California Edison inquiring if we would be interested in selling them gas. I was courteous and considerate of his

request and told him that we would talk about it, but I at the same time told him that the Southern California companies were our customers and that we did not have any lines in California and we only came to the California border, that it had been our policy up to that date, but I would investigate and see what we could do.

Well, the net of it was that we discussed it after that many times with the California companies, and we became satisfied that because of the smog situation in Southern California that there was a real problem being created in respect to the gas supply. There was a difference of opinion between the Southern companies and Southern California Edison in respect to the critical situation created by the smog.

I gave a lot of study to it and I became convinced that something should be done about that demand. I took it up and talked to the California companies in the early part of '56, as a matter of fact as early as February, and we made up our minds that while it was a problem that ought to be worked out on a cooperative basis between ourself, the Southern California companies and Southern California Edison,

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nevertheless it ought to be worked out.

So we worked at it. Actually I believe it was in August that we had a definite conference with the Southen California Gas Company people and they agreed that we ought to try to solve that problem then and that it might be helpful for me to go and talk to the Southern California Edison people, and I did so.

Q. You mentioned that your efforts to acquire a supply of gas to satisfy this Edison demand in view of the smog problem started in February of '56? A. That is right.

Q. Was that prior to your receiving any information with respect to any conversations that might have occurred

between Pacific Northwest and Edison? A. Oh, yes. I do not have any recollection of having learned anything about Pacific Northwest's conversation with Edison until sometime in August, whereas all of my preparation and study of the problem and determination that something should be done was done prior to August.

Mr. Kurtz: Did you say in August of '56 you heard of Pacific attempting to furnish gas to Southern Edison Company?

The Witness: That is right. I heard of conversations that involved a proposition, an effort on their part to bring Canadian gas down to Southern California Edison and supply their demands.

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Mr. Kurtz: Thank you.

The Witness: I would like, as the background of this, for you to understand that Southern California Edison is a very large customer of Southern California Gas Company, and therefore our interest in that matter was not based just on vulgar curiosity. We had a real reason, because one of our customers was about to be deprived of a very large customer, and a customer that was very essential to a reasonable balance of its takes from us.

We felt concerned about it, and I think properly so. I would have thought we would be negligent in respect to our own business and in our obligations to our customer if we had not been.

By Mr. Shannon:

Q. Mr. Kayser, would you comment on the price under this arrangment that you worked out with— A. Yes. When I learned that the price that was considered in the proposal to bring Canadian gas down—and the reason I knew; it had to be about those figures—was somewhere

about 45 to 50 cents, and that was a little bit of a shock to me, that Southern California Edison would be interested in any such price.

Also it had some bearing on my activities, because if they could pay that much, were willing to pay that much, it would have a bearing on our going out and buying gas to

satisfy that kind of demand.

So I made an engagement, I went out to California and talked to the Southern California Gas Company people and confirmed with them that it was all right for me to go over and talk to California Edison, Southern California Edison.

I made a date and went over and talked with them, and at that time I mentioned to them a price of around 40 cents, giving myself plenty of trading leeway, and subsequently offered them—in that conversation I was not in a position to offer anything specific, but subsequently I did offer them a contract for 150 million feet for 38 cents.

I later went out to California and spent several days negotiating it out, and we finally agreed on the contract that is now executed and is the basis of Docket G-12580, and that is the basic price of 30 cents for 100 million, with a kind of string tied to a 25 million a day increment to be delivered each year, if they demanded and if we had the gas.

Now, I remember very clearly why we were able to do that. In the first conversations we were talking about a direct sale for a very long period in which we would take all of the responsibility of being able to meet that price over a long period.

Also it was their first thought that they might want 200 million or 250 million or 300 million feet of gas. Well, that turned out not to be true. 150 was all they were

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talking about.

Then that got down to 100. Then, instead of making a direct sale in which we would have to be responsible to supply the gas at that price, whether school kept or not, for the period of ten solid years, we finally agreed out that the initial price should be 30 cents, and then on a formula it should move up as the price to the Southern California Gas Company moved up for the deliveries at Topock to the Southern California Gas Company.

Now, that materially reduced the risk of the contract, and for that reason we traded on down to this price that we are talking about. Now, that is the history of the price.

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Q. Mr. Kayser, did the existence of Pacific Northwest and the fact of its attempt to sell gas to Pacific Gas & Electric Company have any effect upon the terms which El Paso offered to sell gas, or the nature of the service El Paso offered to furnish, to Pacific Gas & Electric Company? A. No, it did not, but—

Q. Would you amplify your answer on that? A. Of course we make it our business to keep in touch with all of our customers, and I do personally with the larger ones such as the California companies, the Phoenix companies, Tucson companies, and the companies serving El Paso, Southern Union Gas Company, and to find out and know what their demands are. And we, of course, are trying to keep up with the parade and to be prepared to meet those demands.

We, by our contacts, find out what they need in the future, and the terms and nature of the service.

Now those terms, the length of service, quantity, time of delivery, load factor, are determined by the market and not by anyone else under the sun. We sell them a block of gas;

we do not say we will sell you all the gas you need. We could not do that. They would not make a contract like that. We could not make it if we wanted to. We sell them a block originally—to Southern California Gas Company, we sold a total of 305 million a day.

Now, to PG&E, we sold 300 million a day. That is all.

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That is all we had. We came up here and got certificated to deliver that amount.

Now, each time we have increased that service, we sell a block of gas, it is usually in the range of 100-150 million to each company. Now that is the thing that determines the price, terms, conditions, and everything else. And the presence, or the existence or non-existence of Pacific Northwest or any other company, did not determine those prices and conditions.

Q. In the fall of 1956, after Edison was satisfied of the economic infeasibility of Pacific Northwest's proposal, did Pacific attempt to interest Pacific Gas & Electric in taking a supply of Canadian gas? A. Yes, the fact is this: that it was not practicable to bring down gas at an economic figure without having a big load in California. Therefore, the Pacific Northwest properly talked to Pacific Gas & Electric Company in regard to their buying gas from such a project.

Q. Was Pacific Gas & Electric Company interested in such a proposal? A. No. They were not interested in the proposal that we were making them. But they definitely and quickly stated that they were not interested in such a proposal as Pacific Northwest was making for them and Southern California Edison to take large quantities of their gas.

Q. What was their attitude, that is, Pacific's, Pacific

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Gas & Electric's attitude, with respect to the purchase of Canadian gas? A. Since, oh, I believe it is '53, when I first learned of their ideas on Canadian gas, but, since I first learned of it, which I think was in '53, they have always expressed the desire and the determination and the plan to bring Canadian gas down from Alberta to the San Francisco Bay. That has been a determination on their part all of that time. And that, of course, had a lot to do with any answer they gave, either to Pacific Northwest or to me.

In fact, I think it was the determining factor.

Q. Well, after the negotiation of the acquisition by El Paso of the Stock of Pacific Northwest, did you have any conferences with Pacific Gas & Electric Company looking toward the attempt to interest them in Canadian gas? A. Yes, after we had determined that we were going to merge the two companies into a joint enterprise, I believe we had already signed the initial agreement, the first thing that I did was to make an engagement with Norman Sutherland for me and Mr. Boyd and Mr. Perkins, who are our top executives, together with Mr. Fish and Mr. Silloway, to meet with Mr. Sutherland, President of the Pacific Gas & Electric, and specifically offer and urge on him to make a contract with us, saying to him that we had determined to put the two properties together, into a joint enterprise, that we believed we could serve his

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demands better, that is what we wanted to do, and we wanted him to take 200 million feet of gas from a proposed line that we proposed to build, growing out of that situation.

And I might say that we proposed to build it to nearly any delivery point on the California Border that he would

suggest near Klamath Falls, which is at the extreme northern part of the border, or further down on the Nevada part of the border, or at any other point that was satisfactory to him.

But he was courteous, nice, pleasant, which he always is, but his final answer was "no", he wasn't interested, and did not want to buy it.

Q. Did Pacific Gas & Electric thereafter make any announcement with respect to its proposal for bringing Canadian gas to the United States? A. I think it was in July that the Pacific Gas & Electric Company put out the publicity that they had determined and had advanced a long distance in the—

Presiding Examiner: Which July?

The Witness: July, 1957.

(Continuing)—that they had made progress, substantial progress, in the acquisition of gas in Alberta, the organization of the necessary gathering or purchasing company in Canada, the transmission company in the United States, and so forth. It was a very intelligent, carefully and well worked out plan and announcement. And they have since adhered to it and made

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their full—well, they made application first to the Conservation Board of Alberta and in that hearing they showed a very large amount of gas under contract. They likewise were required, I believe it was, to appear before what is known as the Borden Committee, which was what they call a Royal Commission, I believe, to investigate the economics of the gas and oil and other industries and with a particular view to determining what the export policy of the Dominion should be.

They made a very extensive presentation to that Board of their plans and the plans involved bringing 400 million feet of gas to them at San Francisco.

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Presiding Examiner: That is the project of Pacific Gas and Electric you are still talking about?

The Witness: That is right.

Mr. Shannon: That is correct.

Presiding Examiner: Now, upon your map that you introduced as Exhibit 1 there is a showing of a dotted line of a proposed pipeline, I assume by some subsidiary of Pacific Gas and Electric Company called Pacific Transmission Company, or some such?

The Witness: Yes, sir. That is the project.

Presiding Examiner: And was that company by the other name to have been the subsidiary of Pacific Gas & Electric Company?

The Witness: Yes, sir. It is a little involved now. Inside of California I think the plan is that the line will be owned by Pacific Gas & Electric Company—

Presiding Examiner: All I was interested in was explaining Exhibit No. 1 and tying it into your testimony.

The Witness: That is right, that is exactly what it is. And the balance of the Pacific Transmission, I think, has outside interests other than Pacific Gas & Electric.

Then you go up into Canada and I believe that the purchasing company is wholly owned by Pacific Gas and Electric. I think that is the plan. It is a good plan, it is a smart plan and has been pressed as aggressively and effectively

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as any I have seen. And it should be, because Pacific Gas & Electric—there was a nice little article in the paper the other day that they just passed the two billion mark of assets, so I am not surprised at their being able to pre it effectively.

By Mr. Shannon:

Q. Mr. Kayser, in your opinion would there be a reasonable probability that Pacific Northwest, in the absence of its acquisition by El Paso, would in the future sell or offer to sell gas to companies in California? A. Well, from the evidence that is already in in respect to Pacific Northwest's financial position and such position as it can see in the near future, or even as far down the future as you can see, if it has to operate entirely as an independent company I do not see any way in which they can make an effective offer to any of the California companies.

Q. Mr. Kayser, following a unification of El Paso and Pacific Northwest, does California, as a practical matter, have any choice except to buy its additional out-of-state gas requirements from El Paso? A. Well, I started to say I wish that were so, but I do not. I would rather not be in that position.

The fact is this, that both the Southern companies that are under one ownership of Pacific Lighting Corporation, and the Northern distributor, who is Pacific Gas & Electric, have such large

markets, and they are growing so rapidly, that they are the ones who determine who sells them, how much, when, where. All they have to do is to plan their supplies for the future in such fashion as to include Tom, Dick or Harry, if they want to.

They are the ones that have the choice, and they have done that consistently. Pacific Gas & Electric Company says, "We want to bring in the gas from Canada," and they moved in on it in a big way and are doing what they want to do.

The Southern California companies, right while we were

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talking to them, made a contract with Trans-Western for 300 million feet of gas. I believe the Docket Number on that—I promised to get that, I think—it is around somewhere.

Mr. Shannon: It is G-14871.

The Witness: Yes. That company is—the principal owners are a man by the name of Mr. Butler, Gerald Butler, I believe it is, of Houston, who is a very substantial oil and gas operator. We have some contracts with him in the Permian Basin where he built gasoline absorption plants.

Bill Warren, W. K. Warren, is one of the most successful operators in that entire area. He was the pioneer in the building of—well, he and Phillips were the pioneers in building gasoline absorption plants in the Permian Basin, and he accumulated a greater number of those plants than nearly anyone, besides

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accumulating a substantial amount of oil business. He then merged that company into Gulf and became one of the principal stockholders of Gulf.

Now, the other stockholder of Trans-Western is the Monterey Oil, which is a Los Angeles institution, of very fine reputation and strong position.

There are others with minor amounts of stock.

Now, they got the full support of Gulf Oil Corporation in that Gulf has sold to them practically all of their uncommitted gas in the areas of the Permian Basin and part, at least, if not all of the West Texas Panhandle Area. The application is on file. I do not know when it will be set, but I am merely citing it as an instance in which the Southern California market was able to put their finger on the one that they wanted to serve them. That condition still exists.

By Mr. Shannon:

Q. Are the California distribution companies under any obligation to take their increased requirements from El Paso? A. None whatsoever, and we have no obligation to supply them and no right to supply them.

Q. In your opinion, Mr. Kayser, by the unification of El Paso and Pacific Northwestern, are the consumers of natural gas in California deprived of any substantial benefits which they might reasonably be expected to enjoy through the separate and independent existence of Pacific Northwest?

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A. No, I do not think so. On the contrary, I think that by putting the two together, and that is our purpose in doing it, we do put ourselves in a better position to serve them more economically at cheaper rates, if you want to know, to be explicit, and with greater flexibility than they could be served by the two companies separately.

Q. Just one further matter. Turning now to the possible effects of unification of El Paso and Pacific on the development of gas supplies in the regions from which each system presently draws its gas supplies, with respect to the Permain Basin from which El Paso takes large quantities of residue gas, in your opinion, by the unification of El Paso and Pacific Northwest, is exploration and development of gas supplies in the Permian Basin deprived of any substantial stimulus? A. No, not in the least, so far as I know.

Q. Does Pacific have any access down to that area at all? A. No, and I cannot think of any reason why they would come in that direction. The natural development of their area would be to the North.

I would say this, that if we are permitted to get access to the dry gas reserves of the Rocky Mountain region and

vill be in a much better position to market
ıe Permian Basin.

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will also be in a better position to explore
'ermian Basin and all along our lines. I
stified to the fact that the merger would
aso in respect to supply and in respect to
ial supply, and that it will stimulate ex-
Paso, which in turn will stimulate explora-
ependent operators.

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ıannon:

w to the San Juan Basin, Mr. Kayser, in
the unification of El Paso and Pacific
ıloration and development of gas supplies
rived of any substantial stimulus? A. No,

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serves in San Juan are in that area. Now
ɛn contracted with the exception of com-
amounts, and the potential is in the, as I
the other day, yesterday, in the Dakota
that is all held by, generally speaking, the
that hold the leases that cover the Mesa
th. So that there is very little so-called
carried on except downward.
udgment is that the exploration for those
upplies will be carried on by El Paso. It
rried on by someone who can afford the
he money. Those wells can cost around

$500,000, and they can be dry. And they generally cost about $300,000.

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You do well to get off in drilling one of those deep wells for $300,000. And you have to be prepared for it to be dry, and absolute loss. Now I think that we probably better than anyone else can do that.

Mr. Kurtz: Are you talking about exploratory wells or—

The Witness: Below the Mesa Verde.

Mr. Kurtz: That is the figure, the $300 to $500, for exploratory wells?

The Witness: Exploratory into that area will cost $300,000 to $500,000, depending upon how far you press it, whether or not you test every little thing you find.

Mr. Kurtz: But the ordinary well, after it is tested, does not cost that, does it?

The Witness: No, I think that those wells could be drilled on a basis of knowing exactly what you were going to do probably for $175,000 to $200,000 a well on a program. But an exploratory well is an entirely different thing, it costs more always.

Now we have a little advantage there in that we have these, as I said yesterday, Mesa Verde wells which can be deepened down to that point. The Mesa Verde wells cost $90,000 to $100,000 apiece down to 5,000 to 5,500 feet in depth.

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Cross Examination

By Mr. Kurtz:

Q. Mr. Kayser, just at the close of yesterday's testimony you were referring to the fact of other projects, proposed

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projects, to take gas into California. You mentioned the P. G. & E. Line, and I think Transwestern line.

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Q. Well isn't this a fact, that all of the estimates that have been made in the past, all subsequent estimates thereafter, have been greater? A. Now you are covering a lot of territory. The statistical—its nature. I can answer that this way, that the growth of California, in their demand for gas, has progressively increased each year. Now the estimates made by the California people have, to my judgment, been pretty clear and pretty accurate.

They every time have shown that as they go along they have increased progressively, every time they are looked at. To say that every one of their estimates was too low, I am

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not prepared to say that. I think that they have been very accurate in what they have done.

Q. I think you have answered it in this way: At the time you were even building service to Topock for P.G. & E., you did not contemplate a market as big as it is today, did you? A. No. No, I am sure that I did not.

Q. And this competition that you have mentioned for the California market, that has been with you for considerable time by different companies, has it not? A. Yes, sir, that is correct.

Q. Well, for instance, your San Juan project. There was competition there? A. That is right, yes.

Q. And P. G. & E at one time was looking at the reserves in the Church-Butte area, were they not, of Wyoming? A. The Church-Butte areas in Wyoming?

Q. Yes. A. That is correct, because they were originally

thought to be very large and turned out not to be.

Q. And then, of course, you have the West Coast, and you have, bringing it more down to date, that I know about, the West Coast and the Pacific Northwest at various times investigating the possibility of serving the California markets, is that not correct?

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A. That is right.

Q. Now am I correct in my understanding that you believe that El Paso—and when I say El Paso, if I say you, I mean your company, it is all the same as far as I am concerned—believe that they can render more cheaper service to the distributing company than any other company that is now proposing to render service in California? A. Yes, sir, we believe that we could, and we have striven in that direction, to deliver the most efficient and cheapest. Cheap not in the narrow sense of cheap, but mathematically cheaper, yes, sir.

Q. We are talking about dependable service all the time, I hope. A. That is right, that is correct.

Q. Well while the competition proposed may be present, or proposed competition may be present, you still would like to be, and think it would be for the best interests of the people of California if you were, the only supplier? A. No, I do not think that.

Q. You do not think that? A. No, I never have.

Q. Why? A. Well, if the California market, which they have demonstrated is their judgment, had rather supply any block of their demands outside of the El Paso Company, that is for

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their judgment, not mine.

Q. Well I appreciate that. But let's get a little bit beyond that stage. In other words, a regulated monopoly

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running into the State of California could render better service than if there was not one single system, is that correct, in your judgment? A. Well, that is a big broad question.

Q. I appreciate that, I imagine you have given it a lot of thought. A. We have, indeed, given it quite a bit of thought.

Q. I have reference to the benefits to the people of California. That is what I am talking about. A. I would say that, taking into account the service, I believe that a regulated company, one company serving a given area, and such area as the Commission in its judgment would say is the area to be served, I do think that it could be served more efficiently by one company than by two companies in the area.

Now there again someone has to have the judgment to say what is the area that should be solely served by one company. Consequently, where it is regulated under the system of regulation that now exists, namely, in which anyone has a right to apply and then the Commission is to say whether or not it will be in the best interests of the service, then that situation, I think, puts in the hands of the Commission the power to see

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to it that the service is kept efficient.

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Q. All right.

Well, let's take it down to date. In the Aneth Field, which hearing was just going on, Trans-Western had a contract to buy certain volumes of gas out of that field; did it not, at one time? A. Yes, they had the Superior.

Q. And you are now contracting with that company, are

you not? A. That is right. That is the superior Oil Company.

Q. Well, would it be fair to say that you were aware of the possibility of the moving of gas from Canada to California as far back as 1946, let us say, when the Northwest Natural Gas Company had an application to serve the Pacific Northwest? A. No.

Q. You did not.

The first time that you became aware of the possibility of moving gas to California, then, would be at the time the Westcoast Transmission Company talked with P. G. & E.; would that be correct?

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A. No, the first time that it became apparent to me that it could be moved was after the certification of Pacific Northwest and the possible combining of the services of Pacific Northwest with the gas from both ends. And having that much service along the line, it made it seem to me to be practical, and I thought we had framed up a very good plan in the Mountain Home line to make available to California the gas from Canada. Now that is the first time that it ever looked practical to me.

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Q. Well, now, at this time, has the Board in the Province of Alberta deferred the application of Westcoast and also the application relating to PG & E, whatever that is— A. Alberta Southern.

Q. Have they deferred disposition of those applications until further showing of gas supply is available?

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A. No, that is not what they have done, Mr. Kurtz.

Q. What have they done? A. What they have done is issue an order and a report which pretty clearly states the

amount of gas that the Board now considers as surplus beyond the needs of the Canadian consuming areas, and have suggested that because the total of that amount is not as great as the total applied for by the two companies, (namely, Alberta Southern, which is the Pacific Gas & Electric Company's project, and Westcoast, which is Pacific Northwest's project—there is not enough to satisfy all of those demands; so the suggestion has been made by the Board that those companies revise their applications so as to conform to the quantity that is available.

Q. Well, what quantity is that available? I do not know. A. Well, I am sure that the amount is 350 million a day.

Q. Over and above the requirements of the Canadians? A. Right. Surplus gas for export.

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Q. Well, my problem is as it now stands, Pacific is a wholly-owned, for all practical purposes, subsidiary of El Paso. I am trying in my own mind to determine, when you talk of merger, whether or not you have reference to the fact that El Paso still will continue to operate Pacific or not, and I think that you are thinking of the trust suit in Salt Lake City, are you not? A. I am thinking about both of them, of course. The two are related, obviously.

Now, let me say, if you do not mind, since you bring that up, that in describing where we changed over from operating as a separate company, as we said in the beginning that that was our then intention, and we said, I testified, that we found upon getting into it that obviously there were many things that we could do better if we did not have two corporations, and that we could make a more unified, efficient organization of it by merging the two properties together.

But our ideas on that were considerably stimulated by the fact that the attorney general of the United States was

preparing to file an anti-trust suit against us. Now, we gave consideration to everything involved.

I used to be a lawyer and you are a lawyer. The issues in the antitrust suit are different from the issues in the

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merger. The whole public interest is involved in the merger before the Federal Power Commission, and as you know, the law puts the primary jurisdiction to determine whether or not the company should be merged in the Federal Power Commission.

So for every reason, our own personal reasons, our own self-interest, and in order that the entire situation, the public interest, could be properly considered, we filed just as quickly as we could prepare it an application for the merger.

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Q. So when you are actually talking of merger, you are thinking of Pacific being merged into El Paso for the future years? A. That is right, acquiring the properties themselves and assuming the obligations.

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Q. If it had not been for the antitrust suit, and you still operated Pacific as a wholly owned subsidiary, and that you are the managing director of Pacific, you could and would still build a pipeline to Eugene under your studies, is that not right? A. Your assumptions were that there was no—

Q. You would operate Pacific the same as El Paso, would you not, under your policies? A. But your assumptions were that the antitrust suit was not there?

Q. Yes, was not even in existence. A. Well, that is a

great big assumption. (Laughter.) It is a little difficult for me to tell you—

Q. You can not divorce it, in other words? A. Yes. I would like to say this, that if the Attorney General of United States would be nice enough to write us a letter and say "We do not think there is merit in the suit and we would like to dismiss it", we still would want to pursue here with you this merger.

Q. Yes. A. Right. And we do not have any plans what to do with the company after if you should deny this and the suit should still be pending.

Q. Now what plans have you for building a line to the central part of Nevada, around Reno? I heard the statement

here by the Attorney General of Nevada, and I can appreciate his position, but have you any such plans at this time? A. Well, I want to tell you just exactly what I told the Governor and Senators and everyone else.

We are making an engineering and economic study of, I can say, all the communities of Nevada because we feel about Nevada just exactly like we felt about Arizona when we went through Arizona with the big high-pressure pipelines to California. We were taking large volumes of gas through Arizona. Now I will illustrate it by saying that you might just as well think you can take a lot of fine beef bones through a bunch of hungry dogs and not be bitten as to think you are going to take all of that stuff through an area—(laughter) that is literally—through an area that was not starved for, but very hungry for energy, BTU's. So common sense indicated to me that we make provision for them.

Now as far as we can, and we are putting a big line, high-pressure, that is our proposal, through a part of Nevada. It is not through the central portion of it like it was in the case of Arizona. But we are going through

there, and our policy is to investigate, and whenever we can, in a growing community particularly, I have used the expression, we would be willing to give the benefit of the doubt as to whether it is practicable or feasible at the time it is examined so long as the community shows good prospects for growth. Now that is

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exactly what we are doing in Nevada today.

Q. Well you had the same situation when you went out of San Juan, Flagstaff and so forth, did you not? A. Just exactly. The same only it was easier there because our lines go right by them. Prescott was the one that gave us the most trouble. I mean by that, we had to build considerable pipeline to get down to Prescott.

Q. Yes. But without the line from San Juan to Topack there would not be gas service in there today? A. That is correct, unless we had projected the line from plains across.

Q. That is— A. That is right, without those lines going through there we could not, you could not, get service up there.

Q. No one would want to buy the gas, for sure, at the price charged. A. That is right.

Q. And it is the same way in northern Nevada, you could not serve— A. There is a similar situation there without a doubt.

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A. That is right. But when we went to Arizona the same situation applied, and those communities are growing very, very rapidly.

Q. Certainly.

Well, so we can get this over with, at this time you know of no feasible way to serve the cities of northern

California unless you have a line that is moving gas onto a big market such as California?

Presiding Examiner: Mr. Kurtz, I think you mis-spoke yourself. I think you meant to say northern Nevada. You said northern California.

Mr. Kurtz: Nevada.

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Q. Now, as to the State of Idaho, the statement was made here that you would connect other communities. The statement that you have made, that is the policy statement that you have just mentioned, that wherever it is feasible you will run a line to it? A. That is correct. Or, in addition to that, now, this other thing is important—

Q. All right. A. (Continuing) —that we will give the meter and the tap for service off of our line if someone else disagrees with us as to the economics and wants to build to it.

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Mr. Furbush: Mr. Kayser, there has been some testimony in this proceeding concerning Pacific Gas Transmission Company's line that is proposed to be constructed to the California Border from the Canadian Border.

The Witness: Right.

Mr. Furbush: And that testimony has been directed toward the proposition, I assume, of showing that there are other potential projects for the bringing of gas to the State of

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California.

The Witness: That is right. And to show the whole picture of the supply situation.

Mr. Furbush: Now, in light of that contention, Mr. Kayser, will you please state for me now whether or not

either your company, El Paso, or your company, Pacific Northwest, or the merged company, will oppose the application before this Commission by that company for authorization to construct that line?

The Witness: We will not. We have not and we will not.

Mr. Furbush: That is a direct statement of policy of the company at this time?

The Witness: I am making it.

. . . . . .

Mr. Kurtz: I have a question.

How about the Trans-Western. Are you opposing that?

The Witness: We have intervened and we intend—our only interest, we are not opposing it; we have never opposed it, and our only interest is to see that the same standard in respect to proven reserves is followed in relation to Trans-Western as is followed in relation to us.

Mr. Kurtz: Well, aren't you opposing some sale by Gulf to Trans-Western?

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The Witness: Not that I know of.

Are you talking about the—

Mr. Kurtz: I do not know. I am not familiar with that project.

The Witness: All right, I think I know what you are talking about.

Obviously, there is no point in our opposing a sale by Gulf to Trans-Western, because we know the relationship between them, and that just does not make sense. But I think what you have reference to is that Gulf has made application to be permitted to abandon a service to El Paso in the Permian Basin of some residue gas.

Now, I do not even know whether they intend to sell it to Trans-Western or not. I would assume so. But our opposition, now, is not based upon what they are going to

do with it; but it is based upon their taking it away from us—a service. Now that is before the Commission, and it is up to you to decide it. But I don't mean it is up to you personally; it is up to the Commission to decide. I have not much doubt about that, but it is up to them.

But that is the only point about it, and we will always, of course, oppose the discontinuance of a service by any supplier in the field, producer or otherwise, where we have built facilities and are rendering service to our customers based upon that supply.

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If you do not do that, why, you are coming to pieces, obviously.

Mr. Kurtz: Well, there is more than one way of opposing an application, and that is if you are able to secure the supply of gas that the other party contemplates on, they do not have an application.

The Witness: There is a tremendous difference in opposing it and prosecuting my own business; see?

Mr. Kurtz: That is right.

The Witness: And that I am doing.

Mr. Kurtz: I gather that, sir.

The Witness: That is right. That is the way that is. I am not opposing.

Mr. Kurtz: And your business is to supply gas to California along with your other customers; isn't it?

The Witness: You bet you; and to do it as cheaply and efficiently and as abundantly as I can.

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Mr. Furbush: Mr. Kayser, is there anything that occurs to you at the present time that would happen in the prosecution of your own business that would lead you to indirectly oppose the Pacific Gas Transmission's line?

The Witness: Oh, no. I would say that as to a given piece of gas in Canada—and this has already happened—where Pacific wants to buy it, Pacific Gas & Electric wants to buy it, and I need to buy it for the needs of my customers, I am going to compete to buy. Now that is not directly or indirectly opposing the proposition. However, I am perfectly willing to work out a plan under which, because of the amount that is available to come out, work out something by which it can be gotten out on a mutually satisfactory basis. And I have told your people that identical thing, and I am willing to tell

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it here on the stand. That is just a question of economics and I think a constructive rather than a destructive move.

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W. V. Holik, Jr.

By Mr. Grambling:

Q. Mr. Holik, will you please state your name for the record? A. William V. Holik.

Q. Are you employed by the El Paso Natural Gas Company, the applicant in this case? A. Yes, sir, I am.

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Q. What is your position today, Mr. Holik? A. At the present time I am Assistant to the Vice President and Manager of Pipeline Operations, and have the responsibility of assisting the Vice President in matters relating to the general company operations.

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Q. In your capacity as Assistant to the Vice President and Manager of Pipeline Operations, are you familiar

and operation of El Paso's existing pipe-
d properties? A. Yes, sir. I am familiar
operations and with the properties owned

generally familiar with the facilities and
e Pacific Northwest Pipeline Corporation's
s, sir, I am.

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please refer to Items by reference A, B,
ke such comments as you deem appropriate
. A. Well, Items A, B, C and D are flow
ve been incorporated by reference.
e flow sheets, A-3-107, A-3-108, and A-3-109,
nitted to the Commission in Docket G-11797-
5. These three flow sheets when considered
the over-all design operation of El Paso's
y existed at the time of the filing of Docket
with the additional facilities proposed in
include El Paso's main line delivery to
two billion 704 million cubic feet per day.
What date was that?
: That was submitted, to my recollection,
1957 and was approved in March of 1958.
This represents the capacity of El Paso's
ay, January 1, 1957?
: It includes that capacity plus the addi-
to bring it up by a total of 187 million cubic

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So the capacities of January 1 of 1957 and
958 are the same.

The Witness: That is correct, subject to check, Mr. Kurtz, in this manner. We had received prior authorizations and whether all those facilities were completed or not I

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couldn't state at this time.

Mr. Kurtz: Well, subject to your check, we can use this figure—

The Witness: That is correct.

Mr. Kurtz: —that you gave.

The Witness: That is correct, sir.

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Q. Mr. Holik, would you now point out the existing interconnections between El Paso and Pacific's facilities? A. El Paso and Pacific have interconnecting facilities in the San Juan Basin of northern New Mexico and southwest Colorado. El Paso owns and operates a 24-inch O.D. pipeline connecting Pacific's processing plants at Ignacio, Colorado, and El Paso's Blanco plant in northern New Mexico.

Q. How far apart are they, Mr. Holik? A. They are approximately thirty-five miles apart.

Now, it is through this interconnecting pipeline that we receive the 101 million cubic feet per day from Pacific's plant which is in exchange for a like amount of Canadian gas which El Paso delivers to Pacific near the International Boundary at Sumas, Washington.

There are also several interconnecting points between the gathering systems of the respective companies in the San Juan Basin and, through these points of interconnection, El Paso and Pacific are exchanging volumes of wellhead gas in the field.

Now, this integration of gathering facilities is of

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benefit both to El Paso and Pacific. By this means, we have eliminated duplication of gathering facilities and have obtained greater flexibility and a higher load factor by this interconnection in the San Juan Basin area.

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Q. Mr. Holik, you have heard Mr. Steen testify that Pacific realized a capital saving of approximately $4.5 million as a result of exchange agreement in the San Juan Basin.

Will you explain in greater detail just how that saving

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was brought about? A. Yes, sir.

Prior to the construction of Pacific's gathering facilities in the San Juan Basin, the two companies met and discussed plans for an orderly development of the Basin. There were numerous meetings and discussions which occured, and they resulted in a broad general agreement for the use of each party of the other's gathering facilities and the exchange of volumes of gas which it was felt would eliminate any duplication of gathering facilities and would enable the existing facilities to be utilized to their maximum.

Mr. Kurtz: About when was that?

The Witness: That was, as I recall it, in early 1955, and I am drawing on recollection now, Mr. Kurtz.

Mr. Kurtz: Thank you.

The Witness: Now, since El Paso owned and operated a rather extensive gathering system in and adjacent to the areas which Pacific desired to take gas from, they were able to make a considerable saving in the cost of construction of their initial gathering system.

By Mr. Grambling:

Q. Who is that, Pacific? A. Pacific was.

Now, these savings, together with additional savings realized subsequently by the continuing use of this exchange

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agreement, amounted to approximately a capital savings of $4.5 million.

In general, the exchange agreement works in this manner: Where Pacific has gas or leasehold interests in gas purchase contracts in areas which are removed from Pacific's system but are close or adjacent to El Paso's system, the gas is tied into El Paso's system. Where El Paso has gas wells or leasehold interests in areas which are adjacent to Pacific's system but away from El Paso, we tie into Pacific's system. And all the volumes are measured and pay-back is received by the party in deficit at one or more of several exchange or balancing points located in the field area where their main gathering trunk crosses our main gathering laterals.

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M. C. Norwood

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Direct Examination

By Mr. Grambling:

Q. Mr. Norwood, would you please state your name for the record? A. M. C. Norwood.

Q. Are you employed by the El Paso Natural Gas Company, the applicant in this case? A. Yes, sir, I am.

Q. How long have you been employed by that company? A. Since January 1, 1948.

Q. In what capacity? A. I am Controller of the company.

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Q. Would you tell us briefly some of your primary duties as an officer and Controller of the El Paso Natural Gas Company? A. My duties include responsibility for the preparation of such items as the company's budgets, various statistical data and reports furnished to or filed with financial institutions, Governmental agencies and others.

I am responsible for the preparation of cost studies and forecasts used by the company in passing on the feasibility of contemplated projects, gas purchase and gas sales contracts, lease acquisitions, financing programs, and the filing of applications with the Federal Power Commission, as well as numerous related and like matters.

I consult with others in the company on major problems, including those that may arise in connection with gas tariffs, rate filings, accounting, gas purchase and gas sales contracts, tax problems, and so on.

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Mr. Grenier: Could I ask a question here, also? I just don't quite follow this, Mr. Norwood.

As I recall Mr. Silloway's testimony, he said that in 1957 there was a loss, if my figures here were right, of some $2,067,000 before preferred dividends.

What is the difference between that figure and the ones that we are looking at here on the Sheet 3?

The Witness: What was that figure you had, Mr. Grenier?

Mr. Grenier: Mr. Silloway—I don't have the page reference in the transcript. I just was looking back through my notes here, though, and I see on the first day he said that Pacific Northwest had had no net income for the calendar year 1957 but, instead, it had a loss before preferred dividends in 1957 of $2,067,000. I am having a hard time putting that together

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with what I see here.

The Witness: I think his testimony also referred to a transaction that involved the sale of securities of Westcoast Transmission to El Paso Natural Gas Company; did it not?

Mr. Grenier: I don't know. If that is so, it might—

Mr. Shannon: Is that the item "Other Income" on this schedule, Mr. Norwood?

The Witness: Yes, that is right. It is reflected under "Other Income".

Mr. Grenier: It would have to be about $1.7 million or something like that.

The Witness: That is right. It is $1.7 million.

Mr. Grenier: Where is that?

The Witness: It is included in the item shown opposite "Other Income" under the caption, "Pacific Northwest Pipeline Corporation".

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Mr. Kurtz: Mr. Examiner, one moment. I believe it would be an appropriate time—today is Friday. These exhibits of Mr. Norwood do not include the sales or a cost-of-service study which reflect the 470 million in Docket G-16235 or the 100 million in Docket 15696.

Now, this is what I had reference to at the time Mr. Holik was on the stand.

Now, to bring this back down to date to the same place so we have a common ground as El Paso is going to operate upon after the merger, then we have to have those figures, particularly those sales figures which are very important, and the cost of service, likewise. Those are the two items.

I am not talking about all this material that he has gone through this afternoon, but I would assume that over

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the weekend he could certainly take and put together the sales and the cost of service study to include those two dockets, as they undoubtedly must be, to be a matter of combining the figures in Docket 16235 and in this other Docket 15696.

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Mr. Grambling: I just want to be certain there is no misunderstanding of what we are getting up for you.

The Witness: In order that I know for sure, in order that I may know exactly what you want, Mr. Kurtz, may I ask a question?

Presiding Examiner: Certainly.

The Witness: You want the consolidated sales after the merger, including the sales that are proposed in Dockets G-15696 and G-16235, and additionally you want a cost-of

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service showing the cost of service including those proposed sales?

Mr. Kurtz: I think that is all that I need to have, because the application of Pacific in its Docket G-16236 I assume would be wiped out.

The Witness: May I have that again?

Mr. Kurtz: Docket G-16236.

The Witness: You say you assume—

Mr. Kurtz: The application of Pacific Northwest that was filed, companion application to El Paso's 16235 under a—if they were giving effect to a merger, I assume that this application would be nothing.

The Witness: Yes. You want to include—you want a cost of service that assumes the merger?

Mr. Kurtz: That is correct, with those sales for the two companies, the 470 million and the 100 million.

The Witness: And you want the sales, of course, for

the first three full years of operation of that, or do you want it for one year, or—I am just trying to see what we can do.

Mr. Kurtz: I will have to consult just a minute. You have raised another point on me now.

Mr. Norwood, I was thinking—the first year of operation of the volume of the Provo line I believe is 1960, isn't that right?

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The Witness: Well, the first full year is 1962.

Mr. Kurtz: Yes. But there is a definite volume in 1960.

The Witness: There is a volume in 1960.

Mr. Kurtz: How about just the two years, 1960 and 1962?

The Witness: For the sales?

Mr. Kurtz: Yes, and the cost of service.

The Witness: You want a cost of service for both periods, then?

Mr. Kurtz: Yes.

The Witness: Very well, Mr. Kurtz.

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K. M. Robinson

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Direct Examination

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By Mr. O'Kelly:

Q. Please state your name, residence and occupation. A. My name is K. M. Robinson, Spokane, Washington. I am President of The Washington Water Power Company of Spokane, Washington.

Q. How long have you held that position? A. I have been President of that company since 1938.

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Q. Will you briefly describe the business of Washington Water Power Company? A. The Washington Water Power Company has been in the electric generation and distribution business in Eastern Washington and Northern Idaho since prior to 1900. It also owns and operates a water system in Clarkston, Washington, and a steamheating plant in Spokane, Washington, and is presently constructing a hydro-electric project in Western Montana.

On June 2, 1958, the company became engaged in the natural gas distribution business by merging with Spokane Natural Gas Company, which distributed natural gas to approximately 10,000 customers located in and around Spokane and a small number of customers in smaller cities and towns in Eastern Washington and Northern Idaho.

On the 29th of August of this year, the company acquired the gas distribution properties of Cascade Natural Gas Company in Lewiston, Idaho, and Clarkston, Washington. We are constructing additional facilities in our general service area

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as rapidly as can be economically justified.

Q. How does The Washington Water Power Company receive its supply of natural gas? A. Its sole source of supply is Pacific Northwest Pipeline Company. Pacific supplies, or, we expect, soon will supply our various distribution systems through gates located at or near Spokane and Pullman, Washington, and Coeur d'Alene, Post Falls, Moscow and Lewiston, Idaho. We have contracts with Pacific for the supply of gas and are served under tariff schedules on file with this Commission.

Q. Mr. Robinson, of what importance is gas to the economy of the Northwest? A. The Northwest and particularly our service area requires natural gas at a reasonable cost if we are to continue our industrial development. There is no oil and little coal in our area and it is essential that

we have an economical fuel available. Natural gas appears to be our only or at least our main hope.

The economy of the Northwest has been based primarily on hydro-electric power and, to a great extent, on subsidized power sold at a low rate. But this is passing. The cost of hydro-electric developments is increasing rapidly and there are only about six to seven million kilowatts—or ten to twelve years' growth—of economical hydro-sites that are not either constructed or under construction or licensed. But even at the

low rates prevailing in the Northwest, electricity is not competitive as a fuel in many types of industry. We have been in the electric business for many years but we have come to realize that natural gas, at a reasonable cost, is essential to the prosperity of our area and to us both as an electric and a gas distributing company.

Q. What is the general condition of the natural gas business in your territory at the present time? A. It has been and to some extent is in a very difficult position.

Spokane Natural Gas Company started serving natural gas in our territory in the fall of 1956. It was not able to build its load very rapidly and by January of this year it was in serious financial difficulties. We found it necessary to take over their operation by the merger route to save the gas industry our area.

The Cascade Natural Gas Company which serves or served numerous small cities and towns in eastern Washington, and northern Idaho has had a similar problem and in order to secure sufficient capital to carry out its obligations in other parts of its operations, it sold to us their Lewiston, Idaho—Clarkston, Washington properties.

The key to the survival of the gas industry in our territory—and in the whole Northwest, in fact—is the rapid development of load or customer usage to carry the heavy

investment in transmission and distribution lines and related equipment.

Q. What are the important factors in a load building program? A. The most important factors are economy and public confidence.

Q. And what can you say about the economic factors? A. Gas is relatively costly in our area. It is competitive at the present time but somewhat on the borderline. Any increase in wholesale rates which would require an increase in our rates would put us at a serious competitive disadvantage and would slow up the growth of the natural gas business in our area to the detriment of our customers and our area as well as to our company.

Q. You mentioned public confidence as a factor. Would you explain that? A. Gas being a new fuel in our territory, people are quite understandably suspicious of it. If we are to expand our sales rapidly enough to make our operation successful, we must build public confidence by demonstrating the convenience and reliability of gas fuel.

In this connection, the proposed line of Pacific from Spokane to Kingsgate and the tie there with Westcoast Transmission Company, Ltd., is of the greatest importance.

Last October the pipeline south of Spokane was ruptured

and Spokane was without gas for several days. This incident has had and will have a very serious detrimental effect on public confidence and acceptance and can only be overcome by having an alternate source of supply.

Q. In what way do you expect the proposed merger of El Paso and Pacific Northwest as related in this hearing to affect your operations? A. I would expect this proposed merger to have a very beneficial effect on our operations and on the Pacific Northwest.

With a financially strong company as our supplier, we would ourselves have confidence that we could expand our operations as fast as public acceptance can be built, and I feel certain we could build public acceptance much faster with such a supplier behind us. I don't know whether the construction of any particular line is dependent on this merger, but I know from experience that you can get a lot more out of a company that has money than you can out of a company that is scraping the barrel.

I also know from experience that the merged company should be able to operate more economically by the elimination of duplicating functions and services and by utilizing the diversity in loads and sources of supply which will be available to it. This should result ultimately in rates that are lower than would otherwise obtain. From my observations of Mr. Kayser and his organization, I feel confident that we will be given

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fair consideration in the allocation of these savings—and, if we aren't, I know this Commisison will take the proper action.

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Mr. Kurtz: I see.

And just how does the merged company own and operate more economically rather than El Paso and the Pacific Division of El Paso would operate separately?

The Witness: Well, I have never been in the gas business, but I have been in the utility business for some 45 years now and we have never taken over a property and brought it under our management that we weren't able to make economies of various types, and I am sure that the merger of any two organizations that is properly managed

will operate more economically than two independent companies.

Mr. Kurtz: Two independent companies?

The Witness: That is, two that are under separate management, which I now understand these two are.

Mr. Kurtz: If Pacific were being managed at this time by El Paso, your statement wouldn't necessarily hold; would it?

The Witness: Yes, I think it would. We had that experience

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when Washington Water Power Company and Pacific Power & Light were both subsidiaries of the American Power & Light system, and, at the time Pacific's stock was sold to the public and we remained a subsidiary of American, the costs of the two companies rose in excess of $1 million a year the first year of operation after we had been separated.

Mr. Kurtz: And you were not President at that time of Pacific.

The Witness: I was President of Washington Water Power Company.

Mr. Kurtz: But not of Pacific.

The Witness: No.

Mr. Kurtz: You weren't the chief executive officer of Pacific Power & Light.

The Witness: No, but the companies were—the costs were distributed almost equally, increased costs between Washington and Pacific.

Mr. Kurtz: What was that again, sir?

The Witness: I say that when the Pacific Power & Light Company stock was sold to the public and we no longer became affiliates even, our costs of doing business rose over $1 million in the first year following that time, because all of the functions that we had been able to carry out in the

power supply and other things that we had been able to carry out as affiliates were no longer possible with the separation of the companies.

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We, the Washington Water Power have taken over—and when I was President of the Idaho Power Company—we took over properties in a number of cases and there never was a case where we did not operate joint properties after the merger or purchase more cheaply than they had ever been operated prior to that time.

Mr. Kurtz: In other words what you are saying is that you are favoring the merger because you think there would be certain savings resulting from it.

The Witness: I am sure there will be savings, and there will be better use of the facilities of the joint operation than there could possibly be with the separate organizations.

Mr. Kurtz: How is that?

The Witness: Because if Pacific Northwest has to stand on its own as a company and we in the Northwest pay the full charges of the cost of operating the Pacific's system, I think that we stand to have gas rates that are beyond the ability of our customers and our company to pay for.

Mr. Kurtz: What you are saying is that you are treating Pacific as a separate corporation, apart from El Paso, in this statement; are you not?

The Witness: That is right.

Mr. Kurtz: What you are interested in is cheap gas; isn't that right?

The Witness: We are interested in gas that we can sell competitively against coal or oil and make the millions of dollars

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that we have invested in this distribution property profit-

ave low enough industrial gas rates in
an encourage future industrialization of

you say you had to pay all of the costs
st?
es, sir.
right.
Paso's other customers should pay that

o, I think their other customers can make
s that are now Pacific Northwest prop-
eater advantage than they could possibly
the two separate companies.
ther words, you are—what you are talk-
ll of El Paso's customers share in the

es, and with the quantities of gas that
la, it is possible to transmit gas out of
leave enough for us and let some of El
pay their proportionate share for the
rough those facilities.
her words, what you are saying is: You
adequate gas supply at the lowest pos-

at is right, sir.
those that you have mentioned here for

contemplating any further expansion
nities whereby you will need additional

es. We will probably have to serve an-
small towns in our electric service area.
r the Spokane Natural until the second

of June, and we haven't been able to expand as fast as we would like to this summer, but we will by next year.

Presiding Examiner: You mean expand your natural gas facilities, distributing facilities?

The Witness: Yes, both in the towns we are now serving and in two or three additional towns in our area.

Presiding Examiner: Towns you are now serving electricity, you want to expand to include natural gas? Is that the way I understand it?

The Witness: Yes; that is, the major ones at least.

Mr. Kurtz: And have you discussed this expansion with Pacific or El Paso people?

The Witness: We have discussed it with the Pacific people; yes.

Mr. Kurtz: And they are agreeable to it.

The Witness: Oh, yes; they would like to make some use of that gas they have in the system.

Mr. Kurtz: That is the desire of any utility; is it not, sir?

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The Witness: Certainly it is the electric, and I am sure it must apply to the gas.

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Bernard T. Poor

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Direct Examination

By Mr. Brosnan:

Q. Will you please give your name and address to the reporter? A. Bernard T. Poor, 4240 Montfort Place, Seattle, Washington.

Q. Mr. Poor, what is your present position?

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A. Executive Vice President and General Manager of Washington Natural Gas Company. I am also a Director of the Company.

Q. What is the background or history of your relationship with Washington Natural Gas? A. In 1953, I was first employed by the company—it was then known as Washington Gas & Electric Company—as Vice President and General Manager.

In 1959, the name of the company was changed to the present name of Washington Natural Gas Company and merged with Seattle Gas Company.

After the merger, I was named Vice President and Manager of the Southern Division of the company.

In November, 1956, I was elected Executive Vice President and General Manager of the company and moved to its headquarters in Seattle.

In 1958, I was elected a Director of the company.

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Q. When was natural gas first introduced into the Washington Natural Gas system? A. Following the completion of Pacific Northwest's pipeline facilities, first deliveries were made to us in October, 1956. By the end of December, 1956, natural gas was being distributed exclusively throughout our system.

Q. What has been the effect of the introduction of natural gas on the growth of your company? A. Well, we have had an increase of 25 per cent in the number of customers served since the introduction of natural gas. We have had a 100 per cent gain in maximum-day firm requirements for our system and a 400 per cent gain in total daily requirements

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for our system.

Q. How many customers approximately do you have attached? A. About 56,000 which represents an increase from 44,000 customers prior to the introduction of natural gas.

Q. What made this expansion in your operation possible, Mr. Poor? A. An average over-all rate reduction of 25 per cent was the principal factor in increasing firm service, to residential and commercial users. Our industrial sales load was virtually created by our ability to distribute large volumes of natural gas at prices below competitive fuels.

Q. What are your plans for further expansion of your company's operations? A. Our policy is to press vigorously for the expansion of natural gas service throughout our market area. We estimate that we have at present approximately a 20 per cent to 25 per cent saturation of the potential residential users in our service area.

Q. What do you perceive as the most important factor or factors affecting your ability to make a further significant penetration of the potential natural gas market in your service area? A. Our ability to continue to obtain increasing supplies of natural gas at reasonable prices.

Q. Mr. Poor, are you generally familiar with the proposal

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in this proceeding of Pacific Northwest to abandon its facilities and service and the concurrent proposal of El Paso Natural Gas to acquire and operate such facilities and render the service now provided by Pacific Northwest? A. Yes, I am.

Q. Does your company support the proposal of Pacific Northwest and El Paso? A. Yes.

Washington Natural Gas Company supports the merger proposal.

(524)

Q. What are your reasons for supporting the merger, Mr. Poor? A. Well, I have attended these hearings from the beginning and have listened to and read the testimony of Mr. Kayser and the other policy and financial witnesses for El Paso and Pacific Northwest. I am persuaded that their purposes and reasons for the merger, and their plans for operating the merged properties, so far as they affect us, are desirable and sound.

Q. Which particular features of the El Paso-Pacific Northwest proposal will be of particular benefit to your company? A. Well, first, as we understand the merger proposal and the plans for operating the merged facilities, we see no adverse effect on our company resulting from the merger.

Secondly, on the affirmative side, we think that the plan, as expressed by Mr. Kayser, to hold to existing rate levels

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on the Pacific Northwest portions of the system for at least a year following the merger will be unquestionably beneficial to the development of our market area.

Also, as we understand the testimony of Mr. Kayser and Mr. Silloway, the merged company will be in a better position to procure and bring to market additional gas supplies for the Pacific Northwest as required. With the prospect of expanding requirements for our distribution system, we think that this is an important benefit to us.

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The Witness: If I remember correctly the statements of Mr. Silloway, it was to the effect that the merged company would have better financial backing to go out and procure additional reserves at the times they were being developed or were available.

Mr. Kurtz: Well, are you contemplating any future expansion at this time that would require additional volumes of gas over those that you have estimated?

The Witness: I tried to imply that when I stated that we had a residential saturation of only twenty or twenty-five per cent, which we believe means that we will be growing for a great number of years and that we will need increasing volumes of gas year after year for the indefinite future.

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Mr. Kurtz: Do you think this merger will affect the rate level other than just the savings that will come about by the integration of the administrative expense?

The Witness: The first statement that we had in mind was the agreement on holding prices which could be beneficial. It would be a year longer to attach business.

The other economies have been somewhat outlined by the policy witnesses and I don't know as I can expand upon them.

Mr. Kurtz: Well, in your petition to intervene in this case you favored the merger; didn't you?

The Witness: Yes.

Mr. Kurtz: What compelled you at that time to favor the merger?

The Witness: Basically the two reasons that have been expanded here in the last few days: Maintenance of price and, we believe, perhaps better development of reserves.

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533

Direct Examination—resumed

By Mr. Grambling:

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Q. Will you next refer to Exhibit 19 and explain that Exhibit? A. Exhibit 19 includes a statement that Applicant does not at this time, as a result of the undertakings set forth in this Application, propose to make any changes in its FPC Gas Tariff relating to rates, charges or classification of service. The services now being rendered by Pacific Northwest will be continued by El Paso under Pacific's FPC Gas Tariff to be reissued in the name of El Paso. Upon the acquisition of the facilities of Pacific Northwest by El Paso, as contemplated herein, there will no longer be any need or occasion for contracts providing for the sale or exchange of natural gas between said companies. Therefore, the effect of the proposed

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merger will only require, at this time, the cancellation of agreements and rate schedules which provide for transactions between the two companies.

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Mr. Kurtz: Exhibit Number 23.

All right, go ahead.

The Witness: (Continuing)—Schedule Number 11, line 15, the amounts of tax credit for carry-forward credit for Pacific is shown there, and this particular computation on this schedule is for the year 1959.

Mr. Kurtz: And those loss carry-overs you took advantage of in the year 1957?

The Witness: The loss carry-overs?

Mr. Kurtz: Yes.

The Witness: No—

Mr. Kurtz: Well, this is not the total amount of loss carry-over that results from the acquisition of Pacific's properties; is it—this 23 million?

The Witness: Well, perhaps we are talking about two different things, Mr. Kurtz.

I understood that you were concerned with the loss carry-forward credit that had been incurred by Pacific prior to the acquisition of Pacific stock by El Paso, and that is what this figure deals with.

Mr. Kurtz: I see.

Yes, I am most likely not reading it correctly.

The carry-over of Pacific's losses prior to 1957 of 23 million plus, that is the total loss carry-over prior to 1957; right?

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The Witness: There may have been a small additional amount that we could not utilize, but it is substantially all of it; yes.

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The companies are presently filing on a consolidated return basis. They are not permitted to use this loss carry-forward on that basis, that is, the losses that were incurred prior to the acquisition of the stock.

If the companies are merged, then they will be permitted to utilize that carry-forward loss to the extent that the income justifies it.

Mr. Kurtz: When you are talking about the loss prior to 1957 of the $21 million figure, I believe it was—

The Witness: $23 million plus.

574

Mr. Kurtz: (Continuing)—that is the one that you are not permitted to utilize at this time by filing a consolidated return?

The Witness: That is right.

Mr. Kurtz: All right.

(574)

Then, if we have the year 1957 and the year 1958 and the year 1959, we will have the benefits taxwise under the plan that you are now operating under, as Pacific as an operating subsidiary; is that right?

The Witness: Yes.

Mr. Kurtz: What is that total?

The Witness: I do not believe I can work it out because I do not have the year '57 figure here, Mr. Kurtz. I can give you the approximate figures for the years.

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Mr. Kurtz: Now, as I understand it, if the two corporations are merged, then you can utilize the $23,734,923?

The Witness: Yes.

Mr. Kurtz: But you cannot utilize it if they are not merged?

The Witness: Well, that will depend on what—they cannot utilize it unless Pacific's income by itself, standing alone, is enough to utilize it.

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Mr. Kurtz: When you referred to the fact that there would be no change in Pacific's rates, you had reference to the statement: "At this time", of Mr. Kayser, that there would be no increase for one year? Pacific's rates?

The Witness: Well, yes. I had—

Mr. Kurtz: I am trying to find out what you mean by "at this time", how long that extends.

The Witness: Yes, I had reference to that. But in our discussion of the rates, we do not propose to change it at this time.

Mr. Kurtz: Today? Is that what you are talking about?

The Witness: Yes—

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Mr. Kurtz: Well, I mean "at this time" kind of leaves the inference that sometime in the future, which may be thirty days, sixty days, you would want a rate increase.

The Witness: No, no. I had reference there to what Mr. Kayser testified to.

Mr. Grenier: May I ask a question right there?

Mr. Norwood, do these earnings statements of yours assume the continuation, then, of all of the presently effective rate increases of El Paso?

They do not make any assumptions about any of them going out, do they, in whole or in part?

The Witness: No, they do not.

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584

Harold Z. Frank

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Direct Examination

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By Mr. Grambling:

Q. Will you please state your name, Mr. Frank? A. Harold Z. Frank.

Q. Please state your occupation and qualifications to appear as a witness in this case. A. I am a Senior Valuation Engineer in the Forecasting Section of the Valuation Department of the Pacific Gas & Electric Company. I am a registered professional engineer in the branch of Mechanical Engineering in the State of California.

I entered the employ of Pacific Gas and Electric Company in March of 1947 and, since May, 1949, I have been preparing estimates of customers, sales, revenues, and re-

lated production expenses for the Gas, Electric, Water and Steam Sales Departments.

These estimates are used in various hearings before the California Public Utilities Commission and the Federal Power Commission, and for numerous purposes by the management of the Company.

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586

Q. Was this Exhibit 29, which you have before you, which is entitled "Market Data of Pacific Gas & Electric Company", prepared by you or under your direction? A. Yes, it was.

. . . . . .

Q. Please explain this exhibit, what is in it, generally, and the basis upon which it was prepared. A. This exhibit shows the market for gas in the area served by Pacific Gas and Electric Company and relates said market to the available gas supply.

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On page 1 of Exhibit 29 is shown a summary of Pacific's annual requirements for the actual years 1955 through 1957 and for the forecast years 1958 through 1965. The basic assumptions and the methods used in preparing these estimates are found on pages 11 through 14, inclusive.

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On page 3 of this exhibit is shown the Relationship of Northern California Natural Gas Requirements under abnormal peak day temperature conditions to Available Supply.

It should be noted that with the additional supplies from El Paso and the Canadian Project of Pacific, a firm de-

ficiency of 97 million cubic feet per day is estimated in the season 1965-1966.

Q. And that takes into consideration the 402½ million cubic feet per day which you expect to get beginning January 1st, 1961, from PG & E's Canadian Project. A. That is correct.

Q. All right. Proceed. A. On page 5 is shown pictorially the figures shown on page 3.

The available supply is the summation of available California gas, PG & E sponsored Canadian gas project, El Paso gas, and gas available for firm peaks.

On page 10 is shown the relationship of annual requirements to supply.

Line 7 shows the PG&E sendout which, in effect, is the amount of gas PG&E expects to purchase. For 1958, this amounts to 505,697 million cubic feet and increases to 696,748 million cubic feet in 1965. Of the quantities shown on line 7 for the forecast years, I estimate that PG&E will purchase the following amounts from El Paso:

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1958 355,827 million cubic feet
1959 378,791 million cubic feet
1960 414,803 million cubic feet
1961 410,123 million cubic feet
1962 417,538 million cubic feet
1963 427,047 million cubic feet
1964 434,858 million cubic feet
1965 439,611 million cubic feet.

Q. Does that complete your testimony on this exhibit, Mr. Frank? A. It does.

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Mr. Furbush: Mr. Frank, I notice that counsel referred to the Bay area.

(600)

Will you please advise us as to whether or not the Pacific Gas and Electric serves an area a little, somewhat larger than the Bay area?

The Witness: Yes, it is quite a bit larger than the Bay area.

Mr. Furbush: It takes in more than northern and central California.

The Witness: That is correct.

Mr. Grambling: You don't take in any part of Los Angeles, do you?

The Witness: No, sir; we don't.

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603

Mr. Kurtz: Well, you mentioned something about the Canadian gas. Have you worked on that project any?

The Witness: Just to include the amount of Canadian gas in its relationship to the over-all supply and requirements of the company.

Mr. Kurtz: Just what is the setup? Is P. G. & E. forming a corporation to move gas to the Canadian border and then a separate corporation to move it to the California border, and then P. G. & E. pick it up, or does the separate corporation move it from the California border to San Francisco?

The Witness: There are a number of companies involved.

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Mr. Kurtz: I meant what is the proposal, just generally?

The Witness: Generally speaking what you said I believe is correct, that there is one company bringing it to the Canadian-U.S. border and another company bringing it down to the California border, and P. G & E. taking over from there.

Mr. Kurtz: To the California border?

The Witness: Yes.

Mr. Kurtz: And then P. G. & E. would move it in under their own name.

The Witness: Yes.

Mr. Kurtz: And what is the price of gas at the California-Oregon border?

The Witness: I don't know.

Mr. Kurtz: Wouldn't you have to know that to make these forecasts, your market forecasts?

The Witness: No, I don't.

Mr. Kurtz: You mean price doesn't make any difference to you in your forecasts?

The Witness: Not in this particular regard.

Mr. Kurtz: What do you mean by that?

The Witness: We have a substantial market existing. We have to go out and procure gas at the cheapest possible price, and if other people in our company, particularly management, believe that it is economical to bring this gas down, we certainly can use it or our customers can use it.

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Mr. Kurtz: That is what I thought. You would be interested in price to the market. It does to a certain extent reflect the price that you pay for gas, does it not?

The Witness: It will, yes, eventually. You would have to have rate cases if the price was abnormally high, but I wish to say this, that I had nothing to do with figuring any cost of gas to the California border.

Mr. Kurtz: Well, I wasn't interested in that particular phrase of it or attempt to question you upon that. What I was interested in was the price that you were thinking of at the California border for the Canadian gas, and you don't know.

The Witness: I don't know.

Mr. Kurtz: Do you know what it is at the Canadian-United States border?

don't know for sure.
you come back, will you find out for

ainly.
n't know as if that is within the scope
y. This is not a proceeding in which
ric Company is attempting to prove
y of their project. The only purpose
indicate, at the request of El Paso,
et that is available for the certificated
prospective gas that El Paso intends
d Electric Company. This is purely

f what is going to be of the market
gas. You might as well ask how much
going to be because that could affect
gas in California.

I would suggest that it is outside the
direct testimony and that it would be
nents made by the Examiner at the
ing for him to be required to come
tion and give that information.

: Mr. Kurtz?

aminer, the price of gas does have a
market estimates. The fact of the
n his quarterly report to stockholders
ry much, that fuel oil prices in Cali-
alifornia market. It seems awfully
d—I don't want to ask him to justify
eems awfully odd to me that the price
e moved into California would not—
—he wouldn't give it any considera-

n in his market estimates. It might be so high that these
rket estimates are meaningless.
Mr. Furbush: Well—
Mr. Kurtz: I don't know until somebody mentions the
ice. It seems a little odd that there would even be any
pute on it.

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Presiding Examiner: Well, what, Mr. Kurtz, does this
hibit purport to show? Doesn't it tell you what the
antities of gas are that may be used in a future period
Pacific Gas and Electric Company?
Mr. Kurtz: I have got the price on that.
Presiding Examiner: I understand.
Mr. Kurtz: But I haven't got the price on this future
s that is proposed to come in from Canada, and he has
t it in his exhibit here.
Presiding Examiner: Where did you get your price for
e gas?
Mr. Kurtz: On file with the Commission.
Presiding Examiner: You mean existing rates?
Mr. Kurtz: Yes. Between El Paso and P. G. & E.
Now, these volumes that he mentioned, and part of this
lume that he mentions is this new proposal, so all I asked
m was the price. That is all.
Mr. Furbush: Well, this is an extremely complex situa-
on, the Examiner will recognize, for this reason. The
l Paso rate is composed of the cost of the initial incre-
ents of gas, the additional increments, the additional
der those, and finally the last increment of gas which,
we all know, is more expensive than the original incre-
ents of gas which were originally certificated to Cali-
rnia.
Now we come along and we are going to have an
ldditional

supply of gas from El Paso. Now, the cost of that gas in and of itself will be considerably higher than the existing certificated amounts of gas to California from El Paso. But it will be rolled in undoubtedly in some future rates proceedings and you will have a certain price for the entire amount of gas delivered to California.

Now, this Canadian project probably has a price somewhere equal to the incremental cost of new supply of gas to California.

Now, I am just trying to point out the complicating factors you will get into when you attempt to compare the price of a new supply of gas, but the only important and significant purpose of the price of gas to the determination of the marketability of gas is whether or not it is going to be more than the amount that the market will bear. And—

Presiding Examiner: Well, how else are you going to prove that it is more or less than what the market will bear unless you know the price?

Mr. Furbush: Say it is less than so much.

Presiding Examiner: Well, let us don't get into those fine points. I think it is a proper inquiry for the reasons stated, some of them by yourself, that we find the price of that gas if they have a price, or the anticipated price.

Mr. Kurtz: I have no further question beyond that.

Presiding Examiner: I think it is a proper inquiry to make

as to what the price is, so that we may know whether it is going to meet any competitive prices down there. So the witness will please bring that in and make the reply when he can on further cross-examination.

Now, is there anything further at this moment?

Mr. Letton: Yes sir.

Mr. Frank, just to be sure on one point here, I thought that I understood you to say that you had assumed the new Canadian supply as coming in on January 1, 1960, whereas your exhibit in the various footnotes seems to show it starting January 1, 1961. I wonder if you could straighten me out on that.

The Witness: I believe your point is well taken. It is January 1, 1961.

Mr. Letton: That is all I have.

Presiding Examiner: Now, is that P. G. & E.'s own gas from Canada?

The Witness: Yes sir.

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610

Edward L. Dunn

Direct Examination

By Mr. Grambling:

Q. Mr. Dunn, will you state your name, address and present position. A. Edward L. Dunn, 724 Ninth St., N. W., Washington, D. C. I am employed by the utility consulting firm of H. Zinder & Associates, Inc., Washington, D. C., as Vice-President.

Q. Will you state generally your education and experience? A. For the past 20 years I have been engaged in regulatory and utility accounting and rate matters. Prior to this period I attended Missouri University, completed an accounting course of LaSalle Extension University, and an accounting and finance course at Columbia University, New York City.

I was first employed as an accounting clerk by the LaClede Christy Clay Products Company, St. Louis, Missouri, and then as an accountant by National Lead

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Company, 111 Broadway, New York City, until I entered the Accounting Division of the Federal Power Commission in March, 1937.

My principal duties with the Commission were supervising the preparation of the major electric and natural gas rate case

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exhibits and testimony. Also I was assigned to state and city regulatory agencies to prepare and testify in rate cases many times.

My position with the Commission was head of the Rate Investigations Section, Division of Accounts, Bureau of Finance Accounts and Rates.

Since February 1951 I have been employed in my present position which has consisted primarily of preparing studies, reports and testimony on the matters involved in natural gas rate and certificate cases.

Q. Have you previously testified before the Federal Power Commission with respect to the cost of service and the allocation of cost of service to the classes of customers of El Paso Natural Gas Company? A. Yes. I have prepared such exhibits in rate cases and certificate cases for El Paso for many years.

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Q. Now, have you got Exhibit 22 before you, Mr. Dunn? A. I have.

Q. I show you a book entitled "Pacific Northwest Pipeline Corporation Docket No. G-13018 and El Paso Natural Gas Company Docket No. G-13019 Material Submitted in Response to Item 6 of

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FPC Letter of June 20, 1958 Pursuant to Section 157.14(c) of the Commission's Regulations Under the Natural Gas Act," and identified in this case as Exhibit 22. Were the

Schedules numbered 1 through 39 contained in this book prepared by you or under your direction and supervision? A. Yes. The basic figures for property investment and operating expenses have been taken from the exhibits previously presented by other witnesses, in this Hearing.

Q. Please state what information was requested by the Commission that has been supplied in this Exhibit No. 22. A. The 39 schedules in the exhibit were prepared in response to the Commission's request for the following information:

(a) System cost of service for the first two calendar years of operation of the merged company.

(b) An allocation of such costs to each particular service classification, with the basis for each allocation clearly stated.

(c) The combined rate base and rate of return.

(d) Gas operating expenses, segregated functionally by accounts.

(e) Depletion and depreciation.

(f) Taxes with the basis upon which computed.

Q. What rate of return was used in the cost of service which you prepared?

A. The return was computed on the basis of a rate of return at 6½ per cent as shown on Schedules Nos. 1, 6, 19 and 31 of Exhibit No. 22.

Q. Will you please state the methods and procedures used in the allocation of the cost of service to the classes of sales? A. The system cost of service for the first two calendar years of operation of the merged company is set forth in Schedule No. 1 attached. The combined rate base,

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rate of return and cost allocated to classes of sales are also shown on this schedule.

The basis for the allocation of such costs to each particular service classification is shown on Schedules Nos. 2, 15 and 28 of Exhibit No. 22. The allocation of costs to customers served from the El Paso division, assuming consumation of the proposed merger, is made on the basis of the estimated sales and costs of the present El Paso Natural Gas Company and four subsidiary companies as named in Exhibit No. 22. The allocation of costs to customers served from the Pacific Northwest division, assuming consumation of the proposed merger, is made on the basis of the estimated sales and costs of the present Pacific Northwest Pipeline Corporation.

The cost of service for El Paso Natural Gas Company and its four subsidiary companies (El Paso) was allocated to sales in existing rate zones. The cost of service is classified by

(614)

functions and zones on the basis of direct plant cost, reserve for depreciation, operating expenses, depreciation expense and taxes in each function and zone. Administrative and general expenses, costs related to general plant and intangible plant and payroll and sundry taxes have been distributed to functions and zones, primarily on the basis of direct labor and direct expenses. Pacific Northwest Pipeline Corporation's (Pacific) cost of service was allocated on a system-wide basis to coincide with Pacific's existing system-wide rates.

The cost allocation procedure is shown in detail on the supporting schedules attached. Such schedules also show details of the combined rate base, gas operating expenses segregated functionally by accounts, depletion and depreciation, and taxes with the basis upon which computed.

Q. Do the various schedules set forth in Exhibit No. 22

contain written headings, side captions, explanatory notes and sufficient detail of figures to make them self-explanatory? A. Yes, I believe the purpose and basis of each schedule is clearly stated on the respective schedules.

Q. Have you before you now Exhibit 23? This is a book entitled "Pacific Northwest Pipeline Corporation Docket No. G-13018 and El Paso Natural Gas Company Docket No. G-13019; Additional Material Submitted in Response to Item 6 of FPC Letter of June 20, 1958 as Requested in FPC Letter of August 18, 1958."

Do you have that book before you? A. Yes, I do.

Q. Were the schedules numbered 1 through 8 contained in this book prepared by you? A. Yes.

Q. Please state what information was requested by the Commission that has been supplied in this Exhibit No. 23. A. The Commission requested that the information requested in Item 6 of the FPC letter of June 20, 1958 be submitted for the company as a single operating unit assuming consumation of the merger.

Q. Will you please state the method and procedures used in the cost of service and the allocation of the cost of service to the classes of sales? A. The cost of service for the first two calendar years of operation of El Paso Natural Gas Company after the merger is shown on Schedule 4 for the year 1959 and Schedule 8 for the year 1960. The cost of service for the respective years is based on the consolidated costs after the elimination of inter-division transactions and reflects the cost of service for the company as a single operating unit, assuming consumation of the proposed merger. Gas supply and other production costs have been pooled. Transmission costs have been zoned to correspond with the existing rate zones. The cost of service is classified by functions and zones on the basis of direct plant cost,

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reserve for depreciation, operating expenses, depreciation expense and taxes in each zone. Administrative and general expenses, costs related to general plant and intangible investment, payroll and sundry taxes have been distributed to functions and zones, primarily on the basis of direct labor and direct expenses. The Pacific Northwest Division is treated as a transmission rate zone and the cost of service of this zone is allocated to the transmission sales in the zone.

The allocation of the cost of service to the sales and service classifications in the respective rate zones is shown on Schedule 1 for the year 1959 and Schedule 5 for the year 1960. Supporting schedules show the basis and method of allocation. The schedules submitted on July 18, 1958, in response to Item 6 of FPC letter of June 20, 1958, which is Exhibit No. 22, show the details of the combined rate base, gas operating expenses segregated functionally by accounts, depletion, depreciation and taxes.

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Q. Now, Mr. Dunn, I believe on Friday the Staff requested certain additional information be obtained, be furnished in the form of an exhibit. I will ask you if you prepared Exhibit 28 which is Tab E under a book entitled "Supplementary Data Requested by FPC Staff at Hearing on September 19, 1958", in Docket No. G-13019. A. Yes.

Q. Was that exhibit prepared by you and under your direction? A. Yes, it was.

Q. For the purpose of meeting the request of the Staff? A. That is correct.

Q. What is this Exhibit generally, Mr. Dunn? A. This exhibit shows the cost of service for the year 1962, assum-

ing the merger has taken place. The cost of service is shown on Schedule No. 4.

Q. Does it show allocation of cost per sales zones? A. Yes. However, I might add that the cost of service for the respective years is based on the consolidated cost after the elimination of inter-division transactions and reflect a cost of service as a single operating unit.

Q. Well, now, will you explain generally about this exhibit. Tell us what it is.

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A. Gas supply and other production costs have been pooled. Transmission costs have been zoned to correspond with the existing rate zones. The cost of service is classified by functions and zones on the basis of direct plant cost, reserve for depreciation, operating expenses, depreciation expense and taxes in each zone. Administrative and general expenses, costs related to general plant and intangible investment, payroll and sundry taxes have been distributed to functions and zones, primarily on the basis of direct labor and direct expenses. The Pacific Northwest Division is treated as a transmission rate zone and the cost of service of this zone is allocated to the transmission sales in the zone.

This proposed 470 M²cf facilities have been assigned to zone 5, which is the existing California rate zone.

Q. Do the various schedules set forth in this exhibit contain written headings, side captions, explanatory notes and sufficient detail of figures to make them self-explanatory? A. Yes, I believe they do.

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Mr. Kurtz: Wait just a minute.

Schedule 1 of Exhibit 28. Pardon me just a moment.

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(622)

Mr. Kurtz: In other words, this exhibit does not roll in all of the costs of the present facilities and the 470 proposal, Provo line, and come up with a rate to the California markets.

Instead of that, it shows different rates for the delivery made at Las—near Las Vegas; is that right?

The Witness: In column 5 it shows the rates both ways.

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Mr. Kurtz: While they may have at the present time set forth separate rates, El Paso may roll all of the cost together and have one single rate to the California Companies?

The Witness: Yes, sir. That could very well be the case.

Mr. Kurtz: If I read this correctly, at the present time the rates of the Northwest Division, which is Pacific as I understand it, Zone 6,—as I read this, the 34.65 cents per Mcf, and to recover full cost of service, and you have set forth

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the cost, it would be 35.54 cents per Mcf?

The Witness: Yes; understanding, of course, these are based upon estimates for the year 1962.

Mr. Kurtz: We are supposed to rely on them; aren't we?

The Witness: Well, the Commission won't let us file any rates until we have actual experience, you know.

Mr. Kurtz: Well, the best estimate that you know of today?

The Witness: That is right. They are for 1962, which is considerably in the future.

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633

Mr. Kurtz: I have one question.

I am not clear about this, Mr. Dunn:

These studies that you have submitted here on the cost of service, do they represent your best judgment as being reasonable and appropriate for determining the cost of service of a single operating company?

The Witness: Well, based upon the information that I have at this time—

Mr. Kurtz: Yes, of course, you would have to base it on that.

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The Witness: (Continuing)—and complying with the requests of the Commission, I think that reasonably portrays what the allocated costs would be.

Mr. Kurtz: Let me ask you this:

Forgetting the Commission's letters, if you were asked to submit a cost study for El Paso and Pacific as a single operating unit, would you submit anything different than you have submitted here?

The Witness: I cannot see any reason, or know of any reason, why I would submit anything different at the present time.

Mr. Kurtz: Or some other circumstance may come up that you might change your mind; isn't that correct? It happens every once in awhile; does it not?

The Witness: Yes, as the system develops I might change my mind.

Mr. Kurtz: Certainly. And the letters that you have reference to, of June 20, 1958, and August 18, 1958, these two letters that I hand you are copies of those letters; are they not?

The Witness: They are.

Mr. Kurtz: Mr. Examiner, I would like to have the letters copied into the record as though read; or, if you desire, I will furnish them as exhibits.

(634)

There seems to be some conflict here about what these letters

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contain. It is a very fine point, I admit, but as long as we are talking about them, we may as well have them in the record.

Presiding Examiner: There is no question about their having a place in the record, but whether they are to be copied into the record or you want to present them as exhibits, I think, would be a matter of choice with you, sir.

Mr. Kurtz: Just have them copied into the record.

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"Office of General Counsel (1)
Federal Power Commission
Washington 25

June 20, 1958.

"Docket No. G-13018
Pacific Northwest Pipeline Corporation
Docket No. G-13019

636

"El Paso Natural Gas Company
"Paul Kayser, President
El Paso Natural Gas Company
P. O. Box 1492
El Paso, Texas.

"Dear Mr. Kayser:

"After review of the Sixth and Seventh Supplements to your application recently submitted in Docket No. G-13019, the staff has found that additional information is needed in order to clear up certain accounting matters.

"(1) In the sixth supplement, Schedule No. 5, it is shown that the total gross profit included in plant charges from

the various Fish Companies for the work performed for Pacific Northwest from inception to May 31, 1957, is $4,295,696.48. Since it appears that these companies have performed substantial work for Pacific Northwest subsequent to May 31, 1957, it is requested that this schedule be extended to indicate the amount applicable to the entire year 1957. The amounts in the first column of Schedule No. 5, representing "From Inception to December 31, 1955", should be broken down by calendar years if any of such items pertain to period prior to 1955.

"(2) The seventh supplement, Schedule No. 3,

Cash Flow Statement, shows an item on Line No. 5, of $17,220,000 as the amount received for sale of 5½ per cent Interim Notes. It appears that these notes were associated with 287,000 shares of common stock and sold in units. Please describe the accounting for the issuance of the securities, including the discount, if any, and expenses involved and the disposition thereof by years. Since the amount received for the notes appears to be the same as the principal amount, does the $757,871.98 included in Account 140, Unamortized Debit Discount and Expense during 1956, as being applicable to these notes represent expenses only. If so, what is the estimated amount applicable to the issuance of the 287,000 shares of common stock. Please explain the basis of any allocation of the discount, if any, and expense between the two securities.

"(3) Your accounting for the conversion of the 5.6 per cent Interim Notes Series B, $4,200,000 appearing on page 40 of the 1957 Annual Report, F.P.C. Form No. 2, indicates that $78,400.00 was charged to Account 100.3, Construction Work in Progress and capitalized. Particulars concerning the basis of the above $78,400.00 charge

are requested. Please explain fully the accounting for the discount

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and expenses relating to this issue of notes.

"(4) It has been noted, on page 9 of the 1956 Annual Report to Stockholders, that interest capitalized on equity funds was reduced by $411,246 which is stated to represent interest cost not chargeable to gas plant in process of construction. However, it does not appear that such a reduction was effected in the computations for interest during construction on equity funds capitalized appearing on Schedule No. 1-B of the First Supplement and, therefore, may be improperly included in plant accounts. Particulars relating to this $411,246 adjustment and your reason for not eliminating this amount from the above referred to Schedule.

"(5) Interim Notes 5.6 per cent Series A—$5,800,000. Information is requested as to whether these notes were converted on June 1, 1958, to preferred stock as planned. If so, the accounting treatment of this transaction should be submitted including the amount of discount and expense that was attributable to these notes and the amount of discount and expense that was charged to Account 100.3, Construction Work in Progress.

"(6) Pursuant in Section 157.14(c), of the Commission's regulations under the Natural Gas Act,

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the following additional information is requested:

"(a) System cost of service for the first two calendar years of operation of the merged company.

"(b) An allocation of such costs to each particular serv-

ice classification, with the basis for each allocation clearly stated.

"(c) The combined rate base and rate of return.

"(d) Gas operating expenses, segregated functionally by accounts.

"(e) Depletion and depreciation.

"(f) Taxes with the basis upon which computed.

"By direction of the Commission. Commissioner Digby dissenting.

"/s/ J. H. GUTRIDE
/Secretary

"Docket No. G-13018
Pacific Northwest Pipeline Corporation
"Docket No. G-13019
El Paso Natural Gas Company

Aug. 18, 1958

"Paul Kayser, President
El Paso Natural Gas Company
P. O. Box 1492
El Paso, Texas.

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"Dear Mr. Kayser:

"This is with reference to your response of July 18, 1958, to Item 6 of the Commission's letter of June 20, 1958, in Docket Nos. G-13018 and G-13019.

"The response shows (1) separately developed costs of service for (a) El Paso, et al., and (b) Pacific Northwest and (2) the addition of these separate costs of service as the system cost of service for the merged system. Ex-

(640)

amination of the material submitted indicates that the system cost of service so computed will not be used in the determination of rates of the merged company under the jurisdiction of this Commission.

"In this connection, your response indicates an apparent misunderstanding of Item 6 of the Commission's letter which contemplated an allocation of the system cost of service for the merged system, not by division into the separate entities corresponding to the present operations, but rather by the methods customarily employed in rate proceedings before the Commission.

"Therefore you are requested to submit immediately the information requested in said Item 6 of the Commission's letter for the company as a single operating unit.

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"In the cost of service shown on Schedule No. 1 of the above response of July 18, 1958, the total shown for Federal Income Tax is $47,933,798 for the year 1959 and $48,841,794 for the year 1960. In Schedule No. 2 of Exhibit N of the El Paso's application in this docket the 1958 consolidated provision for Federal Income Tax is only $146,872; for 1959, $148,336; and for 1960, $10,597,396. Please furnish a reconciliation of these several amounts. In this regard you are also requested to furnish a reconciliation between taxable net income and book net income per schedules in Exhibit N for the years 1958 through 1960.

"By direction of the Commission.

"/s/MICHAEL J. FARRELL
"Acting Secretary.

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Mr. Furbush: Mr. Dunn, directing your attention on that same exhibit for identification, to the same schedule, in fact,

the same page, line 5, the item "California Sales Excluding 470 M²cf Facilities.

Now, that represents, I take it, sales to both of your

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California customers; does it not?

The Witness: That is correct.

Mr. Furbush: Now, the next line, "California Sales, Proposed 470 M²cf Facilities," what sale is that?

The Witness: That is the sale as proposed in Docket G-1635, and it is known as the "Provo to Las Vegas Line Sale".

Mr. Furbush: That does not involve the sale to Pacific Gas and Electric Company; does it?

The Witness: No, it does not.

Mr. Furbush: Then, on line 7, you have total Zone 5, California, and you have on column 9, 32.20 cents per Mcf as compared with line 5, column 9, 30.60 cents per Mcf.

Is my interpretation correct that if a flat rate were established or a uniform rate were established, for Zone 5, to California, that Pacific Gas and Electric Company would be called up to pay 32.20 cents per Mcf, if this cost were directly translated to rates by virtue of the proposed sale to Southern California Companies of the 470 M²cf per day?

The Witness: Yes, sir; if the Commission fixed a uniform rate based on average cost of all California sales, and of course translated for purposes of illustration, a number of 32.20 cents into a rate demand and commodity rate, then the rates would be the same to California Companies on that basis.

Mr. Furbush: That would mean that all of the then-certificated volumes of gas to Pacific Gas and Electric Company

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would be raised from 30.60 to 32.20 cents per Mcf?

(644)

The Witness: If that were done, that is the result using these figures for illustrative purposes.

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Mr. Furbush: And these are the type of figures that you have used in the presentation for El Paso in its most recent cases, is that not so?

The Witness: Well, we never got into this particular type of a situation in any recent rate case because we did not have a separate line, the Las Vegas line.

Mr. Furbush: But you have had similar situations, have you not, on a much smaller scale?

The Witness: No, up to date we have never had an expansion program involving one company and not another in California.

Mr. Furbush: But you have had the San Juan line and the southern line, and you have rolled those together, have you not, to determine the uniform costs in the zones?

The Witness: Yes, I have shown them both ways. In recent years the transmission rates have been put together, but of course in each case the expansion was just about equal for both the southern California companies and P. G. & E.

Mr. Furbush: And on the basis of your many years of experience and your present understanding of the problem, could you tell us what your recommendation would be in this particular instance?

The Witness: No, I could not.

Mr. Furbush: You are unable to at this time?

The Witness: I have not tried to formulate any rate policy that far in the future.

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Mr. Furbush: It would take quite a while to consider something of that nature?

The Witness: Yes, and I would like to be closer to the

date the rates would be effective, too, rather than so far in the future.

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669

Keith Kelsey

Direct Examination

By Mr. Grambling:

Q. Mr. Kelsey, what is your name and address? A. My name is Keith Kelsey, and my business address is 810 South Flower Street, Los Angeles, California.

Q. By whom are you employed, and what duties do you perform?

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A. I am Assistant Vice President of Southern California Gas Company and report to the Vice President, who is responsible for financial, economic, and rate matters.

I am in administrative charge of the Department and, among other things, I make forecasts of market requirements and review forecasts of like nature made by other departments and companies.

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Q. Have you before you an exhibit entitled:

"Pacific Lighting Gas Supply Company, Southern California Gas Company, Southern Counties Gas Company of California—Market Data"?

Do you have that before you? A. I have.

Q. It is entitled Exhibit 83, I believe. Eighty-three. A. Eighty-three; yes, sir.

Q. Will you mark yours accordingly?

Was this exhibit prepared by you or under your supervision? A. Yes, it was.

(672)

Q. What is the purpose of this Exhibit 83? A. Exhibit 83 was prepared to show that southern California contains a large and rapidly growing market for natural gas, that this market is served by Southern California and Southern Counties Gas Companies, and their wholesale customers, and, further, that this market has in the past and will in the future require additional gas supplies in large quantities from sources outside the State of California.

This exhibit was originally prepared to support the application by El Paso Natural Gas Company in Docket G-16235.

Q. Please describe the part of California which this exhibit covers. A. If you will turn to the map following page 1 of Exhibit

673

83, you will obtain a picture of the geographic extent of southern California and the portion thereof served by Southern California and Southern Counties Gas Companies, and their wholesale customers: San Diego Gas and Electric Company and the city of Long Beach.

Hereinafter I will refer to the first two as the "Southern Companies" and to all four gas-distribution utilities as the "Southern Utilities".

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Q. Has the population increase in California been rapid during the past several years, and is it rapid at the present time? A. It has been rapid and has been described by some as "explosive".

The 13 counties had a population of 4,161,000 in 1940, 6,404,000 in 1950, and 9,135,000 at the end of 1957.

The number of customers served with gas by the Southern Utilities has kept pace as there is a fairly steady relationship of customers to population. The population within our service

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area has been about ninety-seven per cent of the 13 counties and has increased an average of 325,000 per year over the past decade, which means that the Southern Utilities builds facilities for and serves gas to 890 additional people every day.

The persons-per-gas meter ratio has been fairly stable, standing at 3.43 at the end of 1957, corresponding to the 2,580,000 active meters as of December 31st, as shown by utility and by service class on page 2 of Exhibit 83. This may be compared with 1,450,000 meters in 1947, and 1,995,000 in 1952.

To project this growth into the future, I have relied upon forecasts of population by the Bureau of the Census, California Department of Finance, Stanford Research Institute, and others. The result has been an estimate of 3,107,000 active meters at the end of 1962, and 3,686,000 in 1967.

The ten-year period, 1947-'57 saw an increase of 1,130,000 meters, a growth of 78 per cent, or an average of 113,000 meters per year.

In contrast, the meter gain in the forecast ten-year period, 1957-'67, is 1,106,000 meters, or a forecast growth of 43 per cent, an average of 110,600 meters per year.

This, in my opinion, is a conservative projection.

Q. How have you translated the meter forecast into requirements for natural gas? A. The temperature-adjusted unit sales to general and commercial service customers in past years have been trended

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and the projection of the trend has been applied to the estimated number of meters to obtain the forecast of total sales to that class of customer.

The requirements of other classes of service were based upon projections of historical experience.

(676)

Q. Does your general and commercial class of service include residential also? A. Yes, it does.

Q. Were the methods used in this forecast and summarized in Exhibit 83 the same as those employed in the past certificate proceedings before the Federal Power Commission? A. The methods underlying the forecast of requirements in this market data exhibit are the same as those employed in prior Federal Power Commission proceedings.

Q. How have those former forecasts of market requirements compared with the later actual experience in southern California? A. A review of forecasts made in the Federal Power Commission proceedings since 1945 has disclosed them to be conservative estimates and that later actual experience has exceeded those estimated demands for gas.

Q. Now, where, in Exhibit 83, may the results of your forecast of gas requirements be found? A. The estimates of the size of the future market for gas in southern California are summarized in Tables I, II, and III, appearing on pages 5, 6 and 7, respectively, of Exhibit 83.

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Q. What does Table I show?

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Lines 6 and 7 show the availability for peak days of proposed increments from El Paso Natural Gas Company and Trans-Western Pipeline Company, totaling 825.4 million cubic feet per day.

The 475.4 million cubic feet per day increment from

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El Paso is covered by letter of intent dated July 30, 1958, while the Trans-Western increment letter for 350 million

cubic feet per day is dated February 7, 1958, amended July 2nd and July 18th, 1958.

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Q. What conclusions do you draw from Table I of your Exhibit 83? A. Table I of Exhibit 83 shows that peak-day firm requirements are expected to increase at an average annual rate of 153 million cubic feet per day; that gas from California sources is decreasing at an annual rate of 48 million cubic feet per day;

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and that the present storage development program will provide an additional deliverability of 25 million cubic feet per day annually.

The net effect is an indicated need for additional gas supply of 176 million cubic feet per day per year.

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Q. Would you summarize the general conclusions which may be derived from your exhibit? A. It is my conclusion that Exhibit 83 demonstrates a large and expanding need for natural gas in southern California served by the Southern Utilities.

It is my further conclusion that the requirements of this market cannot be met to any reasonable degree without large, periodical increments in primary gas from sources outside the State of California.

Table I of Exhibit 83 shows that peak-day firm

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requirements for additional gas are expected to increase at the rate of 176 million cubic feet per day every year.

Table III shows that under normal conditions, 131 mil-

lion cubic feet per day of out-of-state gas supply will need to be added every year in order to satisfy 85 per cent of the fuel requirements of interruptible customers in addition to serving the firm customers.

It follows, therefore, that the 825 million cubic feet per day under letters of intent for delivery to southern California will satisfy the need for out-of-state gas for the next five or six years, at the end of which time additional increments will again be needed.

The picture thus presented adds up to a large and rapidly growing market for natural gas in southern California, for which ever-increasing increments of out-of-state gas will need to be acquired by the gas distributing companies at intervals for as far into the future as we can see.

Q. Mr. Kelsey, in your testimony, you mentioned the fact that the original letter of intent for the taking of gas from Trans-Western Pipeline Company was dated February 7, 1958.

Was that for 350 million cubic feet per day? A. Yes, it was.

Q. You say that was amended on July 2nd.

Did that amendment change the quantities of gas or not? A. It reduced the quantity of gas to 300 million cubic

feet per day to be increased at our option to 350, or automatically to 350 on 11-1-63, whichever occurs first.

Q. Now, you stated it was again amended on July 18, 1958.

Did that change the quantities in any particular? A. No, sir.

Q. In other words, Trans-Western Pipeline Company now has contracted with your companies to furnish the

quantities of gas you have just described? A. Yes, sir; it has.

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Mr. Kurtz: By the way, in making up these statements, what was the price at the California Border that you used for the purchases of El Paso Natural Gas Company?

The Witness: Well, the market data figures are not predicated upon price, the present price being $2.20 plus 20 cents commodity on 14.9 pressure base, which averages about 26.9 cents per Mcf at 14.73 and 100 per cent load factor.

Mr. Kurtz: And the price that you used, the average price you used, for Trans-Western Pipeline Company was how much?

The Witness: Well, I did not use the price in these figures.

The letter of intent calls for the price of 45 cents per Mcf at 100 per cent load factor until the volume goes up to 350, at which time the average price comes down to 42 cents per Mcf.

Mr. Letton: Those are maximum figures, aren't they, Mr. Kelsey?

The Witness: Yes, they are.

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Further Direct Examination

By Mr. Grambling:

Q. Mr. Kelsey, you took into consideration the gas that the Southern Companies are going to get in this Docket G-16235, the 470 million cubic feet from Provo, as well as supplies? Your figures take that into consideration, do they not? A. Oh, yes.

(690)

Q. At what price is that gas being delivered to the California Companies at the border?

Mr. Furbush: I object to that question as not being

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delivered—that has not been proven.

By Mr. Grambling:

Q. Proposed to be delivered.

At what price is it proposed to be delivered?

Presiding Examiner: Wait just a moment. The gentleman has an objection.

Mr. Furbush: I would like to object to turning this case into a showing of comparative prices of gas between comparative projects, because of the thing I pointed out the other day: that if we are going to do that, we are going to have to bring in incremental costs, we are going to have to bring in all sorts of extraneous information, extraneous to this proceeding; and I checked in San Francisco last night, and I was advised that if we are going to turn this proceeding into that type of a proceeding, it will be necessary for us to have witnesses come in and testify as to the cost, our estimates of cost for El Paso to transport gas through their circuitous pipelines which they intend to utilize for that particular delivery.

And, for that reason, I object to any question which is asked as to the proposed delivery, as to the price. They can say what the contracts provide, but that is certainly no indication of what the price will be.

Presiding Examiner: Well, haven't we already in this record some testimony as to what the price of the gas is going to be when delivered at Provo? It seems to me that is already

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in the record. It seems to me Mr. Kayser's testimony contained that.

It was 40-some cents. I do not recall the——

Mr. Grambling: I just wanted to show by this witness when it is delivered at the border, not at Provo, when it gets delivered by El Paso at the border.

All right, if there is any objection, we withdraw the question.

Mr. Kurtz: Mr. Examiner, I think it is perfectly proper.

Here we have El Paso, we have Trans-Western; and I think these are vital matters to the case.

I will ask the question, then:

What is the price at the border off the Provo line?

Presiding Examiner: I think it is highly competent, gentlemen. We have the question of competition, certainly. It has to be considered in this case. We certainly have the question of competition.

It seems to me—I may be wrong—I am waiting for briefs on the subject—it is just one of the things in the back of my head. I am going to let the witness answer the question. I will overrule the objection.

The Witness: My recollection is that the letter of intent provides for a price at the border of 40 cents per Mcf and an 85 per cent load factor, which is about 39 and a half cents at our pressure base of 14.73.

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Mr. Kurtz: And that price at 100 per cent load factor goes down?

The Witness: Would be about 38.4 cents at 14.9, and about 38 cents at 14.73.

These may not be strictly accurate because I worked them out on a slide rule.

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766

Paul Francis McBride, Jr.

Direct Examination

By Mr. Payne:

Q. Will you state your full name and address? A. Paul Francis McBride, Jr., Salt Lake City, Utah.

Q. By whom are you employed? A. Pacific Northwest Pipeline Corporation.

Q. What position do you hold with that company? A. I am General Superintendent of Transmission and Chief Engineer.

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I am responsible for all phases of Pacific's engineering design, cost estimating, and construction of new facilities.

On January 1, 1958, I assumed, in addition to my duties as Chief Engineer, the position of General Superintendent of Transmission Operations and, since that time, I have been responsible for the operation and maintenance of Pacific's pipeline compressor stations, measuring and regulating stations, and other facilities.

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Q. Will you designate for us the points of entry of gas supply into the system? A. We receive gas from Westcoast Transmission Company, Limited, at the Canadian Border. This is indicated by the triangular symbol furthermost to the left on this chart.

We receive gas from El Paso Natural Gas Company between the end of our pipeline at the Canadian Border and Station 18.

We receive gas into our system from the Tip Top,

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Hogsback, and Big Piney Fields in southeastern Wyoming.

These points of entry are shown by the three triangular symbols in the upper portion of the chart above Compressor Station Number 8, as shown on the chart.

We show gas entering the system from the Rangely Field at Station 25 located on the chart above the symbol for Station 4.

Q. Pardon me. What station was that? Station 4? A. Yes. It is directly above Station 4 and immediately to the left of Station 24.

Q. Would you continue, please? A. Also, we receive gas from the Piceance Creek Field, which is indicated by the symbol to the right of the symbol for Station 24.

We receive gas from the Bar-X Field, which is designated by the symbol to the right of the symbol for Station 26, and we receive gas from the San Juan Basin which is indicated by the symbol to the right of the symbol for Station Number 1 at the lower right-hand corner of this portion of the chart.

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Q. Mr. McBride, will you turn to Schedule 2, which commences on page 4 of this Exhibit 340?

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Q. Now, referring to column 10, would you please explain the projects which will be constructed subsequent to 1962? A. This exhibit assumes that those projects listed in column 1, for which no figures have been shown, and

columns 3 through 9, will be deferred for construction until after the year 1962.

Q. Now, referring to line 19 on this sheet, that line

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represents the total for the columns for the years as shown.

Is that correct? A. That is correct.

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Mr. Kurtz: All right. I just thought maybe you might know.

Well, let us turn to Exhibit 338 and let us take your design chart, first year 1958, maximum day, and I am looking at Compressor Station Data.

Under the Horsepower and under the column Required, you show for Compressor Station No. 2, zero, No. 8, zero, No. 9, zero, No. 11, zero, No. 13, zero. Does that mean that it is not required?

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The Witness: Under the particular conditions of markets and supplies assumed in this study, they are not running. No sir. That is correct.

Mr. Kurtz: Well, have they been required in the past, that you know of? Have they been operated in the past, those stations?

The Witness: Yes, sir, they have.

Mr. Kurtz: No. 2?

The Witness: Yes sir.

Mr. Kurtz: How long?

The Witness: I frankly don't know offhand.

Mr. Kurtz: About six hours to warm up the station?

The Witness: No sir. It has actually compressed gas in the past.

Mr. Kurtz: When? What year?

The Witness: I would say, speaking from memory, in the year 1956.

Mr. Kurtz: 19 when?

The Witness: 1956.

Mr. Kurtz: Wasn't that constructed in 1957?

The Witness: No sir.

Mr. Kurtz: In 1956.

The Witness: It had been completed prior to 1957.

Mr. Kurtz: Do you maintain a crew out there?

The Witness: I believe we had a small crew starting some

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time late in 1956.

Mr. Kurtz: Do you still have them out there?

The Witness: Yes sir, we do.

Mr. Kurtz: Why?

The Witness: They are engaged at the moment mainly in keeping up the facility that is now installed there.

Mr. Kurtz: Well, the station is shut down, isn't it?

The Witness: It is on what we call standby. It is ready to run at any time.

Mr. Kurtz: But in none of your studies will it ever be required, isn't that correct?

The Witness: No, I can't——

Mr. Kurtz: Well, have you shown any studies here through the year even 1962 wherein it will be required?

The Witness: I don't know of any filings that we have made recently that show it to be required.

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(800)

Fulton W. Copp

Direct Examination

By Mr. Payne:

Q. Will you please state your name and address? A. My name is Fulton W. Copp and I reside in Salt Lake City, Utah.

Q. By whom are you employed, Mr. Copp? A. I am employed by Pacific Northwest Pipeline Corporation. I am Vice-President of that corporation in charge of rates and sales.

Q. How long have you been with Pacific Northwest Pipeline Corporation? A. I have been employed by that company since July, 1955.

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Q. Mr. Copp, what is the rate presently charged by Pacific for interruptible industrial gas sold to distribution customers for resale? A. Two-point-eight-six cents per therm.

Q. What is the definition of the word "therm" as used in Pacific's rate schedules and in your testimony here? A. A "therm" means 100,000 British thermal units.

Q. Are you generally familiar with the prices charged in the Pacific Northwest for fuel oil used for industrial purposes? A. Yes.

Q. What are those prices expressed in units of 100,000 Btus, that is, on a basis comparable to the rate of 2.86 cents per therm charged by Pacific for interruptible industrial natural gas for resale? A. In the Seattle area, the most recent posted price for PS-400 Bunker-"C" oil was, I believe, about $2.85 per barrel, or about 4.67 cents per 100,000 Btu.

Mr. Kurtz: How much per 100,000 Btu?

The Witness: Four-point-six-seven cents.

I think that I should mention that this is a posted oil price. That is to say, the maximum price. It is also common

[redacted]

knowledge that large industrials in the Seattle area are able to purchase industrial oil in large volumes at prices variously less than those posted.

[redacted]

By Mr. Payne:

Q. If you contain your answer to the Seattle area, Mr. Copp, would your answer be the same as to the Portland, Oregon, area? A. Yes. The prices are approximately the same in the Portland area.

Q. The original question as to this matter of comparative fuel prices related to the entire Pacific Northwest. You have mentioned the Seattle, Washington and Portland, Oregon areas. Have you any further comparative fuel data relating to other areas in the Pacific Northwest? A. No. I don't have data specifically for other areas relating to PS-400 and Bunker "C" oil. However, I might mention that prices for all grades of oil in the areas removed from the Pacific Coast would be materially higher than those in the Seattle and Portland areas, because of the added freight costs.

Q. If Pacific were to increase its interruptible industrial rates, what in your opinion would be the effect upon sales of interruptible industrial gas by distribution companies in the Portland and Seattle areas? A. I believe any increases in Pacific's interruptible industrial rates to the distribution companies in these two areas would result in the loss of some presently connected gas loads if the increases were passed along in the form of higher rates to the industrial user. In my judgment, even a relatively small

increase in Pacific's gas price would be quite likely to make interruptible industrial gas more expensive than industrial oil in the Portland and Seattle areas on a comparable BTU basis. The magnitude of the difference would, of course, depend upon the actual oil prices reached through the special arrangement to which I have already referred.

In any event, it is my opinion that in this situation a number of large industrial gas users would shift to oil. Furthermore, in my opinion, industries requiring natural gas for use in industrial processes because of its unique qualities would to a clear but indeterminate extent be discouraged somewhat from locating in the Portland and Seattle areas because of increasing and uncertain natural gas prices.

In any event, the loss of revenues to distributing companies involved through reduction in their industrial gas sales would, of course, make it more difficult for them to finance their programs to expand natural gas service in the residential, commercial, and industrial classes of service.

The financial impact upon Pacific's distribution customers of lost industrial sales would be particularly severe in the next several years. Most distribution company revenues are at the present heavily dependent upon industrial sales and the importance of these sales to these distribution companies will remain critical until the companies are able to attach substantially new loads in the residential and commercial classes of service.

Mr. Kurtz: Mr. Copp, when are you going to increase your rates to the industrials, to bring about this effect that you have described?

The Witness: We have no plans to increase any rates at this time.

Mr. Kurtz: Then this won't occur?

The Witness: If we should increase the rates, it would occur.

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Q. Mr. Copp, if Pacific were forced to increase its rates for firm natural gas to its distribution customers, how in your opinion would this affect the Pacific's firm sales? A. Well, natural gas sold by the pipe line on a firm basis is to a large degree re-sold for residential and commercial usage. The residential and commercial customers are not generally able to convert to oil as is the case with industrial customers, who in almost every instance on the Pacific system have stand-by facilities.

Since the conversion costs of a residential or commercial customer would doubtlessly appear prohibitive in their view, therefore, sales losses in these classes of service would perhaps not be material. However, of far more materiality I believe is the extension of service to residential and commercial customers, and that would probably be retarded substantially.

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This would include extensions of natural gas service to any residential developments and new commercial enterprises.

As Mr. Kayser has mentioned it is of the highest importance in the interests of expanding natural gas service throughout the Pacific service area that new customers of these types be connected initially. If oil space heating is installed in a new home the probability is that the home owner will resist converting to natural gas until his heat-

ing plant requires replacement because of obsolescence or physical deterioration, a period of about ten years.

Q. Mr. Copp, both Mr. Kayser and Mr. Gueffroy have testified with respect to the extension of the Pacific facilities to the area of the Eugene and Springfield, Oregon, and in the event the applications in these consolidated proceedings are granted and the merger is consummated. Are you informed as to why this extension has not been projected by Pacific as an independent corporation? A. Yes, I am.

Q. Will you state the extent of your knowledge on that? A. May I again say that I share Mr. Kayser's view that in the interests of expanding natural gas service it is of the highest importance that facilities be extended into new areas as soon as possible in order to minimize the resistance and delay in natural gas service growth, which will result from the necessity of supplanting other forms of fuel already in use

in residential, commercial and industrial places.

Eugene, Springfield area will in time, be an attractive natural gas market providing a satisfactory return on funds expended in the construction of transmission facilities required to make gas available in that area.

Its development as a good natural gas market from and after the date of natural gas service begins will be far more rapid if natural gas is introduced before the areas of residential, commercial and industrial growth expands much further than it is at present. Delay in introducing natural gas service will require that growing commercial, residential and industrial fuel needs be satisfied by other and, I may say, oil or coal or some other inferior type of fuel.

The delay will prevent natural gas from sharing in the growth, and in fact reducing the growth to an appreciable

extent and will subject natural gas distribution distributors to additional delay occasioned where gas must supplant fuel uses already established. Pacific is and has been aware of the desirability of bringing natural gas to areas such as Eugene and Springfield, Oregon, at an early date.

Pacific did not have funds available to invest in projects of this size, unless the return promised to be substantial and almost immediate. I believe the public interest in our service area has suffered somewhat as the result of not being able to make these extensions to certain areas such as Eugene and Springfield.

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These areas have been deprived from the benefits of that natural gas, when other areas did have it and they were not too far away.

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Cross-examination

By Mr. Kurtz:

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Q. Now you mentioned something about a line to—did you mention to the Dalles and to Springfield this morning, or was it? A. I was talking only about the Eugene, Springfield area.

Q. Eugene-Springfield? A. That is right.

Q. Adjacent towns? A. Yes, that is correct.

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Q. So it would not be a financial problem today that would keep the line out of Springfield, would it? A. Yes,

I think that it would. While, there would, probably, be a nominal or small return on the investment. There are other places that we could spend the money and get probably a better return.

Q. Where? A. Well, I would elect the Columbian Basin area.

Q. Where in the Columbian Basin area—that covers a lot of territory? A. Out from Moses Lake.

Q. You have got a line to Moses Lake now, don't you? A. Yes.

Q. Where are you going from there? A. Larson Air Base.

Q. Any others? A. That line could then be extended on to the City of Ephrata.

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By Mr. Threadgill:

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Q. The gas that flows into the Wenatchee lateral and the gas that flows into the Spokane lateral— A. Yes.

Q. —are they continuations of the Canadian flow or of the flow from the south, or is it a combined flow? A. I think you would call it a combined flow, sir. It would depend upon what all of your sales are doing at the particular time as to exactly what the combination would be.

Q. Is Station 14 the present breaking point, so to speak, between the directions of flow? A. Station 14 is the connection between what I call the northern portion of Pacific's system and the line coming up from the Big Piney

and San Juan area. You could call it the breaking point, as you term it. I think that is all right.

Q. That represents the point at the present time where the gas—the direction of the gas flow, the direction at the present time is the same as shown here? A. At the present time?

Q. Today. A. I do not believe Pacific is getting 300 million cubic feet from Canadian sources at the present time. Now depending upon their particular plants, the amount of gas they are selling

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right now, how much they are getting from Canada will determine which way your gas is flowing. This is an attempt to show what the system would be in 1962 with the loads as they have been shown on this flow sheet. For any intermediate period, Mr. Threadgill, it would be impossible for me to say exactly where it will be, unless you set a number of conditions.

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Direct Examination

By Mr. Grambling:

Q. Mr. Hill, will you state your name, please? A. Arthur L. Hill.

Q. By whom are you employed and in what capacity? A. El Paso Natural Gas Company as a Manager of the Geological and Reservoir Engineering Department.

Q. Will you please state briefly your responsibilities as Manager of the Geological and Reservoir Engineering Department and tell us briefly your technical training? A. In my capacity, I have supervision over all the geological and exploration and gas reserves supply work and the preparation of gas supply and reserve studies for the

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hearings before the Federal Power Commission in our various cases.

I have been employed by El Paso since April, 1949.

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Q. In these proceedings, you will present the evidence on gas supply for both the El Paso Natural Gas Company and Pacific Northwest Pipeline Corporation; will you not? A. Yes, sir.

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Cross-examination

By Mr. Kurtz:

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Q. Now, do I recall correctly you used to be with the Pacific Gas and Electric Company, did you not? A. I used to work for them you mean?

Q. Yes. A. Yes.

Q. You were with them at the time they made an application to take gas from the El Paso Company, were you not? A. That is correct; yes, sir.

Q. And at that time Pacific was—the primary concern of Pacific was the question of the adequacy of the supply of El Paso Natural Gas Company—they wanted to be sure of it, didn't they, before they entered into the contract? A. Yes, we certainly took a look at the proposed supply which El Paso proposed to rely upon for supplying the initial quantities to Pacific Gas and Electric Company.

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Q. All right. Even Pacific employed De Gollier and

McNaughton to make a survey estimate of certain fields, did he not, of El Paso? A. I believe that is correct.

Q. In other words, to meet the supply becomes all-important in meeting the demands of the California market—that is what I am after—isn't that correct? A. The supply is of extreme importance, of course, in meeting any market.

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Q. I forgot to ask you one thing, Mr. Hill. As an operating problem on the El Paso line, between the residue and the dry gas, could you tell me what would be a percentage,

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percentage-wise, per cent of residue and per cent of dry under which your company could continue to deliver this gas? As I understand it if you get one of them out of balance in some way, it jeopardizes the deliveries? A. No, I will not put an exact percentage on it, Mr. Kurtz. The point is this, that because of the fluctuation——

Q. I understand that. A. —and the availability——

Q. Let me put it this way, maybe we can get it this way. I understand that problem that you have.

Out of your total supply of gas, if 60 per cent of it was residue gas, could you meet your requirements—let us put it that way. A. We probably could.

The thing would vary tremendously because of this question of variation in the availability of the residue gas. We might—our supply might be made up at any one point of 60 per cent of residue gas. If the fluctuations from that particular volume that constituted the 60 per cent were only 5 or 10 per cent, one way or the other, certainly, it would not hurt us. We are in good enough position to take care of it. We have flexibility in the dry gas fields.

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On the other hand, if you cut half of that residue gas out from under us suddenly, we would be in dire straights.

Let me point this out as an example, during this past

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year the number of producing days and, consequently, the allowable in Texas, fell from around 13 or 14 days that it had been running for several months, to 8 producing days per month. We were able to continue to meet all of our requirements by opening up all of the gas wells, all of our dry gas wells everywhere.

I can't say whether if it had gone to 7 days or 8 days we would have been unable to fulfill our requirements.

Of course, that would again depend upon whether it was winter or summer and so forth.

Let us say that the more dry gas we have in relationship to the residue gas, the more flexible we are in meeting our day-to-day fluctuating requirements.

Q. I appreciate that, Mr. Hill, sure, the company that has only dry gas, they have no problems? A. Right.

Q. But you are in the business of marketing residue gas. A. Yes.

Q. And there is, somewhere there is a breaking point, where you would not feel safe in meeting your requirements if the per cent of residue gas, we will say, would be too great. Approximately what per cent do you have in mind? A. I do not have any definite per cent in mind, Mr. Kurtz. There are just too many variables. I do not have any particular per cent in mind.

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Q. Well— A. Certainly, it should not exceed 50 per cent for us to be healthy from here on. In times past, we have taken greater than 60 per cent on an annual basis.

Q. Yes. A. But, that didn't necessarily mean that we could continue to take 50 per cent in the future of residue

gas and have the necessary dry gas there to compensate for any extreme variation. That is why I say you cannot put any particular percentage figure on it.

Q. You just do not leave this just to chance, you go out—you say that you can't put a percentage figure on it—well, in the past have you had any difficulty in meeting your requirements because of this marketing of residue gas? A. Well, we have always met them.

Q. You have always met them? A. We have had some operating problems.

Q. They give you a headache? A. Yes, definitely.

Q. But you have always met them? A. Yes, sir.

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Mr. Furbush: Mr. Hill, there has been some testimony in this proceeding concerning the potential reserves in the so-called Rocky Mountain area.

Could you give me a little information as to where this Rocky Mountain area is, something along those lines; so I will be a little better apprised of that situation than I am at the present time?

The Witness: All right.

For the purposes that we have mentioned it in these proceedings, I would say that we are referring to the area lying north of the San Juan Basin, along the general route and within reasonable limits of the Pacific Northwest pipeline.

Mr. Furbush: Mr. Hill, what basis do you have for your anticipation that this area will develop into a substantial gas-producing area?

The Witness: Well, we know for one thing that the

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necessary sediments are present over a number of the basins in this area for the accumulation of hydrocarbons.

It has been proven in various fields that have been already discovered through there. And the fact that, as compared to many of our major producing areas in the United States, the area is relatively early in its exploratory life.

New discoveries are being made right along in the Rocky Mountain area, and I expect that you are going to see increased activities in the area in search of oil and gas.

Mr. Furbush: Have any of the discoveries in recent years been of a substantial nature?

The Witness: The Big Piney Field in southwest Wyoming, we think, is a substantial discovery and has a substantial reserve. We have entered estimates of the reserves in that field in these proceedings. We consider them real significant.

There is a sizable gas reserve in the Rangely Field—it is casinghead gas reserve; and, of course, while it is very close to the San Juan Basin, the Paradox Basin in southeastern Utah and southwestern Colorado has developed into a very substantial reserve.

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Arthur B. Allyne

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Direct Examination

By Mr. Payne:

Q. Will you state your full name and address, please? A. Arthur B. Allyne, Salt Lake City, Utah.

Q. Mr. Allyne, by whom are you employed? A. I am employed by Pacific Northwest Pipeline Corporation.

Q. What position do you hold with that company? A. I am Vice President in charge of transmission operations and engineering.

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Q. In your duties for Pacific Northwest Pipeline Corporation, are you responsible for all phases of the operation and engineering of the transmission system including the pipelines, compressor stations, and related facilities? A. Yes, I am.

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Q. Will you turn to the table of contents and advise us whether or not any portion of this Exhibit Number 344 was prepared under your supervision and direction? A. The transmission expenses, summaries, which are presented on pages 22 and 23, were estimated under my supervision and direction.

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Q. Moving now to columns 4 to 7, inclusive, I note that there is an increase in the amount of money to be expended for this item during these years.

Will you please explain the increase?

Mr. Kurtz: Just a minute.

Mr. Payne, that is on what page number?

Mr. Payne: Page 22 of Exhibit Number 344.

Mr. Kurtz: Thank you.

The Witness: Based upon our past experience, we have allowed for an annual increase of five per cent for salary and wage costs.

I would also like to point out that due to the fact that our system is not presently delivering the quantities of gas which we had originally expected, we have at the present time reduced our operating personnel to a bare minimum.

In subsequent years we have made an allowance for additional personnel, particularly in those locations where we are especially shorthanded.

Even with such increases, our complement of personnel will be modest compared with most pipeline companies.

The adding of personnel has been assumed to be gradual over the five years as reflected by the gradual increase in costs from 1958 through 1962.

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Q. How was the item entitled "Labor" for operation of transmission facilities appearing on line 14 determined? A. The labor cost of operating the transmission facilities for the year 1958 and succeeding years, through 1962, was estimated again in the same manner as described for other labor charges appearing in lines 2, 7 and 10. We are presently holding the number of regular personnel down to approximately 4 people for every 200 miles of pipeline and have provided three temporary laborers for each 200 miles during the summertime. Consequently, for the year 1958 the ratio of labor to expenses for operation of mains is similar to the operation of other transmission facilities.

We are currently supplementing our regular crews with outside contract help to eliminate the purchase of expensive tractors and other equipment in operating our system. Our main line and gathering systems, approximating 2,895 miles of

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pipeline, are divided into two divisions, one being subdivided into five pipeline districts and the other into six. For more dependable operaton it is our belief that this system should be divided into three divisions. While we do not expect this to be done all at one time, it has been assumed in preparing these figures it will be done over a five-year period, and that the number of pipeline personnel will be increased from approximately 77 in 1958 to a total of 103 in 1962, including regular and temporary hands.

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Q. Line 15 is entitled "Supplies and Expense", and for the year 1958, in column 3, the amount of $411,739 is shown. What does this include? A. This amount represents the total money that will be spent for operating supplies and expense to operate the main transmission pipeline system. This figure was arrived at by taking the number of employees on the payroll, the equipment which the company owns, such as trucks, cars and welding machines, and using the average percentage per employee and the average miles per month on the equipment, and extending the dollars to come up to the annual total amounts to be spent. We have also allowed for outside contract expense to supplement our own regular crews. The total dollars shown are a result of actual experience, plus an estimate of additional monies to be spent as we develop a third division and expand our present pipeline district crews.

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Mr. Kurtz: Are these transmission expenses related in any way to the volume of gas that moves through the line?

The Witness: Well the compressor station operating and maintenance expenses are to a considerable degree a function of

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the volume going through the line, whereas the pipeline system you have to maintain whether you put any gas through it or not.

Mr. Kurtz: Yes. Your big item there, where you might say the difference occurred, would be in your compressor station? Now I note on the flow diagram that was introduced there in evidence that there are certain stations that were not proposed to be operated. Did you take that into consideration in making up this estimate?

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The Witness: Yes, we did.

Mr. Kurtz: What stations did you have in mind—how many?

The Witness: Does your question pertain to stations that we expect to operate in 1958, or the stations that we do not?

Mr. Kurtz: Let's take 1958. Do you have any stations that you will not operate? Let's put it that way.

The Witness: Yes, under the load conditions assumed for 1958——

Mr. Kurtz: What stations are those?

The Witness: This is except for emergency situations which we did not reflect in the expenses. We do not expect to operate stations 2, 8, 9, 11 and 13.

Mr. Kurtz: Now let's go over to the year '59. Will you give me the stations you do not expect to operate?

The Witness: 2, 8, 9, 11 and 13.

Mr. Kurtz: And for the year 1960 the same stations?

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The Witness: That is correct. I believe these figures are based on averages, though, and we probably would be called upon to use them in the wintertime.

Mr. Kurtz: You believe that they are based upon averages. All right, I am talking about stations that you show no operations for at any time during any particular year. For instance, the year 1958, will you operate at any time Station No. 2, 8, 9, 11 and 13?

The Witness: Not as reflected in these expenses.

Mr. Kurtz: And for the year 1959 will you operate at any time the same stations?

The Witness: No, sir.

Mr. Kurtz: The same for 1960?

The Witness: That is right.

Mr. Kurtz: '61 and '62, is that right?

The Witness: That is correct.

Mr. Kurtz: Now am I correct in my understanding that in these expenses you took that into consideration?

The Witness: Yes, sir.

Mr. Kurtz: The answer was yes?

The Witness: Yes.

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Mr. Kurtz: In 1957 did you operate compressor stations 2, 8, 9, 11 and 13?

The Witness: In 1957?

Mr. Kurtz: Yes.

The Witness: Before we received Canadian gas in the winter of 1957 we operated all of our stations except Station 2.

Mr. Kurtz: When did you start to receive the Canadian gas?

The Witness: According to my records, Mr. Kurtz, we took our first gas from Westcoast on October 3, 1957.

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Mr. Kurtz: Well, do these figures that you have here reflect a three-division operation or a two-division operation?

The Witness: They start off with a two-division operation and then they go to a three-division operation.

Mr. Kurtz: When do they go to a three-division?

The Witness: I believe, Mr. Kurtz, we assumed a three-division operation starting in the year 1961. Nineteen fifty-eight, '59, and '60, we still are on a two-division operation.

I might explain that there are a number of areas in this group of people which, of course, apply to field transmis-

sion operations, primarily, where we feel that as we are able we should add more people.

For example, field safety engineers, clerks in the division offices, we have, particularly in our current year, "poor-boyed" the operation with just a minimum number of people.

Mr. Kurtz: Which item are you talking about on this sheet 22 and 23?

The Witness: I am speaking of general personnel throughout the transmission group.

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Mr. Kurtz: All right. Well now, let's take compressor stations, your next item there. For instance, your labor account. In 1957 it was $440,021. Now you have reduced that in '58 to $324,489. Is that a result of the fact that five of your stations you are not going to use?

The Witness: That is primarily the reason, yes, sir.

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Mr. Kurtz: All right, now—Pardon me. I did not mean

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to interrupt.

The Witness: What I want to say is that throughout these five years, we still have, in our opinion, "poor-boyed" the operation; so when we have added people in the Measurement Department over this five-year period—for example, we add a field supervisor from two to three when we go to a third division, and we go in field meter inspectors from 13 in '58 to 15 in '62.

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L. G. Truby, Jr.

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Direct Examination

By Mr. Payne:

Q. Will you state your name and address for the record, please?

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A. My name is L. G. Truby, Jr., and I reside in Salt Lake City, Utah.

Q. By whom are you employed, Mr. Truby? and what is the nature of your employment? A. I am employed by the Pacific Northwest Pipeline Corporation as General Manager of Production.

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Q. Will you please describe the staff over which you have supervision in the course of your current employment? A. As General Manager of the Production Department, I currently supervise about sixty people concerned with production and gathering operations, land and geological functions associated with the operation of leasehold properties in the San Juan Basin and gas purchase contract properties in the San Juan Basin,

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Bar-X area in Colorado and Utah, Piceance Creek Field area in Colorado and the Big Piney area in Wyoming.

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Mr. Kurtz: Mr. Truby, did I understand you correctly to say that there would be no reduction in the drilling

program by reason of the deletion of the Beatrice project?

The Witness: That is right.

Mr. Kurtz: Why?

The Witness: The drilling program that we have provided moneys for is essentially that which we estimate will be necessary to meet our lease obligations in terms of lease, sublease requirements, unit obligations to the USGS and——

Mr. Kurtz: If I understand you correctly, your entire drilling program is only to cover your lease obligations; is that right?

The Witness: It is designed to meet those obligations; yes, sir.

Mr. Kurtz: And if it was not for those obligations, you would not be required to drill as many wells; is that right?

The Witness: That is correct.

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The Witness: We have more capacity in the San Juan Basin, as may be noted in the Thistle application, than would be

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necessary to meet our average day requirements.

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Mr. Wolf: Mr. Tenby, did I understand you correctly in answering a question of Mr. Kurtz a few moments ago that

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whether Pacific participated in the so-called Beatrice Project, the G-10455, or whether the so-called Thistle Project was a project in which Pacific would participate, the number of wells that the company planned on drilling would be the same?

The Witness: Relative to the sources of gas presented in the merger application, 13018 or 19, and the Thistle application, they would be the same.

Mr. Wolf: You say for relative. What is the absolute answer?

The Witness: Well, I think when Mr. Kurtz referred to the large number of wells, there was a different scheme to take gas from the San Juan Basin which involved the drilling of a considerable number of wells in addition to what has been presented here.

Mr. Wolf: I see. Now I thought I heard you say that the number of those wells was 65. Is that correct?

The Witness: Our 1958 drilling program as currently estimated would be 65 Mesaverde wells, or a total of 71 wells when you include the Pictured Cliffs and Dakota wells.

Mr. Wolf: Am I correct in understanding that the reason that these wells will be drilled is to meet, in part, lease obligations, in part, the unit obligations to the United States Geological Survey and other comparable obligations?

The Witness: Yes, sir.

Mr. Wolf: Can you tell me readily now, out of the total

number of wells involved how many will have to be drilled for purposes of other than meeting what you referred to as leasehold obligations?

The Witness: No, our program is designed as an overall program, and on that basis of these estimates was designed to meet all of our obligations. It is hard to say this one well is for one purpose, and one well is for another purpose, because most of them will serve more than one purposes.

Mr. Wolf: In other words, you do not have a given well

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earmarked, for example, to meet the requirements of the Federal Government as expressed through USGS?

The Witness: We turn in plans of development that we operate to the USGS. But, for example, that same well might meet an offset obligation, and it also might be required to meet a sublease and operating obligation. So I do not know how to say one well is for one purpose and one for another.

Mr. Wolf: In any event, as to the total number of wells which you contemplate drilling, the reasons for their drilling are as given by you in your previous answer to Mr. Kurtz?

The Witness: Yes, sir.

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Jack B. Owens

Direct Examination

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By Mr. Payne:

Q. Mr. Owens, will you give us your name and address, please? A. My name is Jack B. Owens. I reside in Salt Lake City,

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Utah.

Q. By whom are you employed? A. I am employed by Pacific Northwest Pipeline Corporation in the capacity of Controller.

As Controller I have charge of all accounting records of Pacific.

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Presiding Examiner: Let us go on the record, gentlemen.

Let me make a statement, first, Mr. Kurtz, of the fact that we have had an extensive discussion off the record and I think that the record should show that, it not being desired to encumber the record with all of the arguments pro and con, as to how long the recess should be.

I have suggested a date which I hope is going to be agreeable to you, that we will resume for cross-examination of the applicant's witnesses on November 12, 1958, and I hope that we can be in agreement upon that date. I am not going to hold that the staff will be required to follow cross-examination immediately with its direct testimony. That was suggested by Mr. Kurtz off the record, that he would not probably be ready to do that, and I am not going to require that you do that, Mr. Kurtz.

Do you want to add anything to that—to that statement that I have just made, or does anybody want to add anything on the record to the statement that I have just made?

Mr. Kurtz: I thought the understanding was a little bit further than that, that is, while we start on this date of November 12, with the desire expressed as far as possible to go right along as much as we can, and while it is not the length of time that I requested that it may be that we would have to have a further recess before cross.

The reason for that——

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Presiding Examiner: Now, wait a minute——

Mr. Kurtz: For further cross.

Presiding Examiner: For further cross?

Mr. Kurtz: It is very simple. We have issues before this Commission that require a great deal of time to study. One of the issues, frankly, is the monopoly question—that is before us.

Presiding Examiner: I do not see how it could be any more, I will say frankly, except to be considered here.

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Jack B. Owens

resumed the stand and testified further as follows:

Cross-examination—resumed

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Q. I wish you would explain—in other words, is it a combination of the methods, unit of production and straight line at the same time?

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When we got into the first year of operation it became apparent that we were not going to deliver at the rate that had been anticipated originally and on which I think that our original depreciation rates were based.

Q. In the period of 1957, when did that become apparent? A. The exact date?

Q. To you, I mean. A. Well,——

Q. Approximately. A. I'd say fairly early in the year, Mr. Kurtz. Along about the latter part of January or February I was informed that our load was not going to build up to what had been anticipated by quite a bit.

So since we anticipated delivering quite a bit less in the year 1957 than had been estimated, we—I use that term wrongly—the management of Pacific decided that the original rates were not valid as applied to the year 1957. To have used those rates would have distorted our income picture. Therefore, we modified those rates to the extent of taking our actual deliveries and com-

paring those to our original estimated deliveries and adjusting our rate downward to apply to distribution and transmission facilities.

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Q. Well, we are talking about the volumes of gas that move through your line—wasn't that the reason for your reduction, or are you basing this depreciation, in other words, on load factor? A. No, sir; I don't—I don't think we are doing that. As I explained a while ago, this figure of 3½ per cent is an estimate which was at the time it made, I am sure, was perfectly valid. This estimate assumed certain deliveries in the first year of operation and certain reserves. When our deliveries failed to measure up to those standards, we thought that some adjustment of that figure was justified. I don't think it is a load factor proposition.

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R. L. Cramer

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Direct Examination

By Mr. Payne:

Q. Would you please state your name and address for the record? A. My name is R. L. Cramer, and I make my home in Salt Lake City, Utah.

Q. By whom are you employed, Mr. Cramer? A. I am employed by Coastal Transmission Corporation in the capacity of both Treasurer and Assistant Controller. However, until September 5, 1958, I was a regular employee of Pacific Northwest Pipeline Corporation. As its Assistant Secretary-Assistant Treasurer, I had primary

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responsibility for the preparation of Pacific's budgets, both capital and operating; various banking relations and activities insuring that Pacific complied with certain requirements set forth in its mortgage, bank loan agreements, bond purchase agreements and similar documents. In addition, I was charged from time to time with the responsibility for special studies such as those relating to economic projections and costs of service.

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Q. Do you know of any savings that could be made as the result of the merger, dollar-wise as the result of the merger between Pacific and El Paso, in other words, considering Pacific as it is now a subsidiary of El Paso? A. Being merged in place of being a subsidiary?

Q. That is right. A. Yes, I think very definitely there could be some savings in the service organization. The amount of that I could not tell you, but——

Q. What savings do you have in mind? A. Well, for instance, some of your management salaries, some duplicating of purchasing, accounting, treasury?

Q. Accounting and what else, purchasing? A. Purchasing.

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Q. Actually, the projection that you have presented here is a bare bone? A. That is absolutely correct.

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Q. A bare bone but adequate, is that right, it can be done on these figures? A. I say it can be done for a period. For a protracted period, I do not think that it can. But, although we have not shown increases, we have gone along on the basis that we can do it at least for

the period represented here; but year after year, it cannot be done. In my estimation.

Q. After the period that you have shown here, you think there might be some need for further adjustment and there might, be some further adjustment needed in the figures that you have shown but this is your best estimate? A. That is our best estimate.

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Ray C. Fish

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Direct Examination

By Mr. Payne:

Q. Will you please state your name, address, and occupation? A. My name is Ray C. Fish.

My legal residence is in Houston, Texas.

I am the Chairman of The Fish Engineering Corporation of Houston, Texas, and several other engineering and construction firms, which are in the same line of business as The Fish Engineering Corporation.

Q. At the present time, what are your principal activities? A. Among other things, at the present time, my companies are engaged in the engineering construction of a $200 million complete natural gas and products pipeline system, approximately 1,200 miles in length for Y.P.F., which is the oil agency of the Government of Argentina.

Q. Did you return especially from Argentina following a request for your presence in this hearing made by the staff? A. Yes, I did.

Q. And what are your plans following your testimony here? A. I will have to return to Latin America in connection with the Argentina project.

Q. Mr. Fish, what has been your connection with the Pacific Northwest Pipeline Corporation and its project?

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A. I was the principal organizer of the Pacific Northwest Pipeline Corporation, served as Chairman of its Board of Directors, and am still a Director of Pacific.

Q. Are you also a director of El Paso Natural Gas Company? A. Yes, I am.

Q. Would you explain the origins of the Pacific Northwest project? A. In 1950, we made preliminary studies indicating the existence of an unserved market for natural gas in the Pacific Northwest states, principally in Washington, Oregon, and Idaho, and devoted our efforts to securing an appropriate gas supply to serve this demand.

Q. When did Pacific Northwest first apply for a certificate of public convenience and necessity? A. In June, 1950, in Docket G-1429, we sought authority to construct and operate a pipeline to serve the Pacific Northwest. We proposed at that time to run the line from the gas-producing areas in south Texas.

Q. Did Pacific Northwest subsequently amend this application and, if so, in what respects? A. We first amended our application early in 1952, when it appeared possible to obtain Canadian gas to use in the project.

We then proposed a reciprocal exchange of gas between the United States and Canada, with Alberta gas purchased by Prairie Transmission Company, a Canadian subsidiary of Pacific

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Northwest, the gas being imported by Pacific Northwest for sale in Washington and Oregon.

At the same time, Pacific Northwest would purchase gas from Panhandle Eastern at River Rouge, Michigan, for resale and for export to Canadian Natural in eastern Canada.

Q. Was there a further amendment to Pacific's application? A. Yes, there was.

In the spring of 1952, the Alberta Oil & Gas Commission denied our application to export gas from Alberta to the United States.

We continued to study the situation, still looking for the maximum quantity of gas at the minimum distance from the Pacific Northwest markets.

We concluded that the Four Corners area was the closest rapidly developing gas area, and we entered into negotiations with Phillips Petroleum for a large block of San Juan gas.

Q. Did you thereafter reach an agreement with Phillips? A. In June, 1952, a letter of agreement was signed by Pacific Northwest, at Phillips' option, for a gas purchase arrangement or a sale of leasehold on Phillips' San Juan acreage.

Presiding Examiner: May I interrupt?

I think I understand what the witness means by the "Four

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Corners" area, but there might be some doubt about it in the record.

It is the corners of four states coming together—just as a statement for the record.

Mr. Payne: Yes, it is the area in northwest New Mexico where the States of Colorado, Utah, Arizona, and New Mexico join.

Presiding Examiner: Thank you, sir.

Mr. Payne: I believe it is the only point in the United States where four states are contiguous.

By Mr. Payne:

Q. It is the Four Corners area you referred to; isn't it, Mr. Fish? A. Yes, sir.

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Q. After the execution of the Phillips' letter, did you

further amend your application in Docket G-1429? A. Yes, in August 1952 we filed an amendment to our application calling for the start of our line in the San Juan Basin at Ignacio, Colorado, but the principal market area to be served in the Pacific Northwest was, of course, not changed.

Q. Did you attempt in the fall of 1952 to purchase from Three States Natural Gas Company rights to gas in the Clear Creek area of Utah? A. Yes, we did.

Q. Why were you interested in this gas? A. I was attempting to establish an additional source of supply in support of our proposed pipeline to the Pacific Northwest. I also had under consideration the possibility of selling some of that gas to the Salt Lake City market.

Q. Were you negotiating for the Clear Creek gas with the view of transporting it to California? A. No, I was not. My aim was to have our proposed line certificated to serve the states of the Pacific Northwest, and this additional source of gas I believed would be helpful to this end.

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Q. Was there a third amendment to Pacific's application

in Docket G-1429? A. Yes, there was. The third amendment in G-1429 was filed in January 1953. It, like the second amendment, in August 1952, contemplated a line originating in the San Juan Basin and extending north to Washington and Oregon. The route of the line, however, was altered to run near new supply areas in eastern Utah, northwestern Colorado and southwestern Wyoming, and to make the sale to Colorado Interstate Gas Company at Rock Springs, Wyoming, for the Denver market, which sale had been made in December 1952. This was the route of the line which was certificated in June 1954.

Q. What steps did you take to firm up your gas supply in the San Juan Basin? A. In early 1953 we worked out the definitive contract by which we acquired Phillips gas reserves in San Juan on the basis of an assignment of leases covering 180,000 acres. In 1953 we developed our holding of San Juan acreage by the purchase of large block of leases from, among others, Colorado Oil & Gas Corporation, Sinclair, Skelly Oil Company and the Chicago Corporation.

Q. Of what importance were these acquisitions to you? A. These acquisitions of reserves formed the basis of our supply in the San Juan Basin to which we added in July 1954 a second large block of Phillips acreage, and in March 1955 a large block of Stanolind acreage. There have been

some additional acquisitions of acreage and a few gas purchase contracts, but the bulk of our reserves in San Juan is represented by the large blocks of acreage acquired from the companies I have just mentioned.

Q. In your opinion, what was the importance of Pacific Northwest to the San Juan Basin? A. I would say that the importance of Pacific Northwest was that it provided the means by which an unsatisfied market demand for gas was attached to the San Juan Basin, helping the development of that portion of the basin in which our reserves were principally located, which by and large was the eastern end of the basin.

Q. Were there any further amendments or supplements to your application in G-1429 after January 1953? A. In August 1953 we filed a supplement setting forth additional supplies committed to Pacific Northwest in Wyoming and Colorado, and a schedule of construction of lateral lines to those new supplies.

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Q. Was there in the various amendments to your application any change in your basic proposal? A. No. While there were changes in the location of the proposed sources of supply and in the route followed to the principal markets, the application at all times involved the basic idea of service to the Pacific northwest. It was toward this end that our efforts were directed from the filing of the original application in 1950 to the time in June 1954 when this Commission issued its certificate to Pacific Northwest.

Q. Mr. Kayser has testified that following the certification of Pacific Northwest on June 18, 1954, you had discussions with Westcoast Transmission Company and El Paso Natural Gas Company respecting the possibility of importing Canadian gas, is that correct? A. Yes, we did. And through the agreement between the three companies executed in December 1954, we were able to arrange for the importation of Canadian gas into the Pacific Northwest system.

Q. Mr. Kayser has also testified that El Paso entered into a comprehensive contract with Pacific Northwest in December 1954 for the exchange of gas between the two companies in the San Juan Basin. What was the advantage of this contract to Pacific Northwest? A. It permitted Pacific Northwest substantially to

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reduce its immediate investment in drilling in San Juan and to spread its drilling expenditures over a longer period of time, while at the same time obtaining the benefit of early deliverability.

Q. Mr. Kayser testified to other agreements between El Paso and Pacific Northwest during 1955 and 1956 and referred to a contract relating to the gathering of gas in

San Juan. What was the advantage to Pacific Northwest in this gathering contract? A. Again, there was substantial financial assistance to Pacific Northwest since, by eliminating wasteful duplicaiton in gathering facilities, it reduced the capital investment by Pacific in the San Juan Basin field.

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Q. Did you ever consider extending service to any areas other than those traversed by your originally certificated facilities? A. In early 1956 during the construction of the line I explored the possibility of Pacific Northwest bringing gas eastward to the Chicago market and discussed this matter with Peoples Gas and Coke Company. Ultimately this project took the form of an additional sale to Colorado Interstate at Rock Springs for resale to Natural Gas Pipeline of America for delivery in the Chicago area. In this connection, in April 1956 we filed our application in the so-called Beatrice Project for this sale of 100 million cubic feet to Colorado Interstate.

Q. Why did you not attempt to have Pacific Northwest Pipeline Corporation itself take the gas to Chicago? A. Colorado Interstate was already interconnected with both Pacific and Natural Gas Pipeline Company, and to avoid duplication of facilities and in order to render the greatest amount of additional service at the lowest cost, a three-way project involving Pacific, Colorado Interstate and Natural

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was worked out.

Q. Were there other efforts on your part to explore the possibility of expansion of the Pacific Northwest system to other markets? A. Yes, in May of 1956 I met with Harold Quinton of the Southern California Edison Company, and we discussed the possibility of a sale of Cana-

dian gas by Pacific Northwest. I had learned that Edison was having difficulty in obtaining all the gas it wanted from the Southern California companies and that Mr. Quinton was interested in obtaining a direct access to gas for the Edison Company.

Q. Would you recall for us what points were considered in your May 1956 discussions with the Edison Company? A. We agreed that we would explore the possibility of putting together a deal whereby we would supply Canadian gas to Edison in amounts in the nature of 300 million cubic feet per day. Our discussions were exploratory in nature, and the only thing we were certain of was that we needed a market for at least 300 million cubic feet to make economically feasible any pipeline that would have to be built. Mr. Quinton and I both agreed that the economic feasibility of the project would be a necessary condition of any firm obligations in the future and that Pacific Northwest would explore the problem of acquiring the supplies needed while Edison would explore the problem of furnishing an adequate market.

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Q. What did you do after your May 1956 discussions? A. I had some preliminary cost estimates made of the capital investment which would be required to construct the necessary facilities. I also began to explore in a preliminary way the possibility of obtaining additional Canadian gas from Westcoast Transmission.

Q. What was the size of Edison's demand for gas? A. Edison initially may have spoken in terms of a need for 300 million cubic feet a day. However, it became apparent quite early in the discussions that so far as Edison itself was concerned, it could not utilize the entire 300 million cubic feet and Edison would have to secure the cooperation of the California distribution companies in order to absorb that quantity of gas—at least initially.

Q. Just how essential was the cooperation of the distribution companies to the proposal? A. The participation of the distribution companies was absolutely essential in order to provide an initial market of anything like 300 million cubic feet. Edison made it quite clear that it alone could not possibly absorb that quantity. On the other hand, it was quite clear a pipeline from Canada to supply a lesser quantity would not have been feasible. We also hoped that by participation of the California distribution companies in the project we could lower the cost of gas. This we hoped to accomplish by making maximum use of the

existing pipeline facilities of the distribution companies and by gas exchanges and back offs. Also, we felt that regulatory Commissions would be more favorably inclined to the project if we had the participation of the distribution companies. In particular, we wanted to avoid the construction of a line which duplicated the existing P G & E line and which would result in immediately parallel lines with gas moving in them in opposite directions. It was entirely clear to me that participation of the California distribution companies and P G & E, in particular, was essential to a feasible project.

Q. Did you take any action at this time to interest the distribution companies in such a proposal? A. No, the Edison Company undertook to do this. On July 30, 1956, we had entered into a preliminary letter agreement with Edison providing for a proposed sale of 300 million cubic feet of Canadian gas. We hoped that this agreement would serve to induce either P G & E or the Southern California Gas companies, or both, to participate in our proposal for the sale of Canadian gas.

Q. Would you state briefly the terms of the July 30 agreement? A. Actually, we signed three agreements on

that date. First, the basic sales agreement provided for a sale by us to Edison of 300 million cubic feet per day on the Oregon-California

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border beginning November 1, 1959. In a separate agreement we stated the conditions under which the understanding in the first letter could be terminated. These conditions were that Edison could terminate prior to December 31, 1956, if it concluded that the proposal was not economically feasible, and that Pacific Northwest could terminate prior to that date in event it could not acquire access to the reserves needed to support the proposal.

The third agreement required mutual consent for any publicity releases.

Q. What was the price contemplated for this gas? A. The letter agreement of July 30 merely stated the price to Edison to be the cost of the gas at the Canadian border, not to exceed 25 cents per Mcf, plus a reasonable transportation charge.

Q. What was the magnitude of the capital investment in facilities which would have been required by this proposal? A. Well, so far as Pacific Northwest was concerned, preliminary estimates showed that it involved some $75 million to $80 million to do the looping and to build the new lines necessary to go from the Canadian border to the California-Oregon border. So far as Edison was concerned, if a line were to be built from the California-Oregon border down to Long Beach, preliminary calculations showed some $90 million would have to be spent. In addition, of course, Westcoast

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Transmission would have had to undertake a substantial capital investment to construct the facilities required to move the additional gas down to the Canadian border, and

this investment may have amounted to well over $100 million.

Q. Would you tell us how Edison attempted to interest the distribution companies in your proposal? A. Mr. Quinton raised the matter with both P G & E and the Southern California Gas Companies in early August, 1956. P G & E rejected the proposal immediately. The Southern California Companies also rejected it within a short time.

Q. What was the affect of the refusals by the distribution companies to participate? A. Delivery of gas to Edison alone was not feasible. We had to have the participation of P G & E with an arrangement for the exchange of gas or the price would have been impossibly high. Before the end of September 1956 Edison informed me that they were terminating our July 30 agreement, and on October 2nd, 1956, gave us formal written notice of termination.

Q. To your knowledge was the refusal of P G & E and the Southern California Gas Companies to participate in your proposed sale to Edison the result of any action by El Paso? A. No, not to my knowledge.

Q. After Edison had terminated its discussions with

you, did you speak directly with officials of P G & E? A. Yes, I had always thought that success or failure of this project would depend upon the participation by P G & E. I wanted to see if I could sell this deal by interesting P G & E and I arranged to see them. I notified Edison that I wanted to make this approach to P G & E without informing P G & E of the termination of our agreement, but Edison advised me they regarded the agreement as clearly over and done with. Thereafter, in October 1956 I met with officials of P G & E and attempted to interest them in taking Canadian gas from Pacific Northwest.

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Q. Did they accept your proposal? A. Did they accept my proposal?

Q. Yes. A. No.

Q. Did you have any further dealings with P.G. and E. in the fall of 1956? A. Yes, following our meeting in October I wrote a letter to Norman Sutherland, the president of P.G. and E., reviewing what I had told him concerning Pacific Northwest, and thereafter in December 1956 I again wrote to him and called on him, this time with Mr. Kayser, and together we continued the effort to interest P.G. and E. in taking Canadian gas.

Q. Did P.G. and E. at any time express its willingness to accept your offer? A. No, and its interest in its own Canadian project undoubtedly had a bearing upon this.

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Q. When did you and the other directors of Pacific Northwest decide to accept El Paso's proposal for the exchange of your stock with that of El Paso? A. Toward the end of October 1956. The exchange agreement in which all of the directors of Pacific Northwest agreed to exchange their stock for that of El Paso was dated November 8, 1956.

Q. Was your decision to agree to the acquisition the result of your inability to make final arrangements for a sale of gas to Southern California Edison Company?

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A. No, it had no relation whatsoever. Mr. Kayser and I began our discussions which culminated in the exchange agreement of November 8, 1956, during August of that year. It was not a new idea. The possibility of an acquisition had been considered by us since at least early in 1955.

Q. When was the first time it was considered? A. In the early part of 1955, before the Pacific Northwest line was built but after El Paso had worked with us to develop the project for bringing in Canadian gas, there were discussions between our companies concerning a possible acquisition by El Paso. The negotiations broke down upon Mr. Kayser's insistence that we go the route of a section 7(c) application to this Commission.

Q. Was a possible acquisition considered at any other time? A. Yes, I had further discussions with Mr. Kayser in December of 1955. He proposed an exchange of stock to be followed by a merger of assets, but we never reached final agreement, principally because of an inability to agree upon price. These particular discussions ended around February of 1956, and discussions of acquisition did not begin again until August of that year.

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Q. In these earlier discussions, was the question of Federal Power Commission approval ever considered? A. Yes. Mr. Kayser from the first discussions in early 1955 made it clear that he wanted to submit the proposed acquisition to the Federal Power Commission for approval.

Q. Why then was the exchange agreement of November 8, 1956, cast in a form which did not require the Commission's approval? A. At all times I took the firm position that any change of ownership had to be accomplished quickly and decisively. This was particularly necessary at the critical stage of Pacific Northwest's operation in the late summer and fall of 1956. For this reason we insisted upon exchange of stock in the manner provided for in the November 8 agreement.

Q. What was the reason for the representation in the agreement of November 8 that El Paso had no present intention to merge? A. We asked El Paso to make this

representation after the Internal Revenue Bureau indicated that it would require such a representation before issuing a ruling that the exchange of stock would be tax free to the stock holders of Pacific.

Q. Mr. Fish, what do you regard as the principal advantages of the unification of Pacific Northwest with El Paso from the standpoint of the regions served? A. I would say that the principal advantages lie in the

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complete freedom of movement of gas which can be made from any source of supply to any market, in getting gas to customers at the lowest possible price cheaper than either company could separately deliver the gas, and reducing operating overhead and the duplication of facilities, in making it easier to finance, in making it easier to expand and in assuring the continuity of service. All of these I consider to be in the public interest.

Mr. Kurtz: May I have that last answer back, Mr. Examiner?

(The last answer, as recorded, was read by the reporter.)

The Witness: I would like to add another thought right to that same answer.

The two systems, El Paso system and the Pacific Northwest system, naturally compliment each other. Pacific had access reserves and needed markets; El Paso had a large and growing market and needed access to Pacific's Canadian and Rocky Mountain reserves. The combined companies could avoid duplication of facilities and investment in the San Juan Basin and could be efficiently operated as a unit. Further, we had the utmost confidence in Paul Kayser and the management of El Paso. They had demonstrated their ability, and we thought through the years had done a fine job of serving California and the other states through which El Paso lines

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run. We had no qualms about their serving Pacific Northwest in like manner.

By Mr. Payne:

Q. Mr. Fish, how would you have dealt with the financial problems which an independent Pacific Northwest would appear to have been facing in the fall of 1956? A. We had two immediate solutions to that problem. One was to obtain additional markets and make additional sales. The other was to ask for a substantial rate increase. It would have been substantially larger than that asked for by Pacific after its stock was acquired by El Paso. And we proposed to file for the rate increase at an earlier time than was done. And if that had not proved to be enough, we were prepared to file still a further rate increase.

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Mr. Kurtz: And you are the largest individual stockholder, are you not, in the El Paso Natural Gas Company?

The Witness: To be honest with you, I do not know. I come close to it—as an individual.

Mr. Kurtz: Well, all of that matter, of course, and the relationship between El Paso and Pacific, are disclosed in your annual reports, are they not, to the stockholders?

The Witness: Yes, I believe so.

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Mr. Kurtz: And then immediately thereafter you filed your application in August of 1952 to take gas out of the San Juan Basin for service to the Pacific northwest?

The Witness: Yes, sir.

Mr. Kurtz: And I believe when you filed that application, El Paso Natural Gas Company filed a petition to intervene in your case; did it not?

The Witness: Yes, sir.

Mr. Kurtz: And at that time, the route of your pipeline was through Clear Creek, Salt Lake City, Utah; was it not?

The Witness: Yes, sir.

Mr. Kurtz: And you were competing vigorously with the El Paso Natural Gas Company for a supply of gas out of the Clear Creek Field; were you not?

The Witness: Yes, sir.

Mr. Kurtz: And the price of gas was raised to your company by the El Paso Natural Gas Company; was it not?

I mean their offering price?

The Witness: At Clear Creek?

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Mr. Kurtz: At Clear Creek.

The Witness: I believe I raised that price.

Mr. Kurtz: You raised that price?

The Witness: As I remember it now, I am a little bit hazy—it has been back, after all, about six years ago——

Mr. Kurtz: Yes.

The Witness: (Continuing) —I thought I had that deal. Now, I really did. I offered them 15 cents and this and that; but, frankly, the Good Lord was looking right over my right shoulder and he did not let me have it. And thank goodness that he gave it to the great El Paso Company.

They bought Utah Natural, and instead of having three trillion cubic feet, probably 300 billion.

I put my line over where the gas reserves were.

Mr. Kurtz: So you lost the gas at Clear Creek, and the sale to Mountain Fuel Supply at Salt Lake, and then you

moved your line over, the route over to Rock Springs in which you also worked out a sale to the Colorado Interstate Gas Company?

The Witness: Yes, sir.

May I add in that same area, almost simultaneously with that, while we were still dealing for Clear Creek gas, we were dealing over on the other side. By that time we had worked out a contract to purchase gas at Rangely, Piecance Creek, Bar X, and the Big Piney area up at Wyoming.

We probably would have changed the route of the line

regardless of Clear Creek, on account of the greater potential gas reserves in the Rock Springs area.

Mr. Kurtz: And there was a potential gas supply in that Rocky Mountain area even beyond what you had contracted for?

The Witness: Oh, yes. When we were up here trying to prove our reserves during the case, my goodness! Big Piney had gone from 46 billion, which we tried to justify, and now I think it is about three trillion. That is a pretty good gas reserve.

Mr. Kurtz: Well, it was in March of—March 31, 1954, that the hearing on your application was concluded, and in June 18, 1954, the certificate was issued to you.

Do those dates sound familiar?

The Witness: Yes, sir; they sound very familiar to me, particularly the last one.

Mr. Kurtz: And then thereafter Westcoast Transmission Company filed an appeal from the Commission's decision in the Third Circuit at Philadelphia, and also Transnorthwest—I believe is the name of the company——

The Witness: I believe that was the name.

Mr. Kurtz: (Continuing) —filed an appeal.

And the Westcoast appeal was dismissed on December 21, 1954, by mutual agreement?

The Witness: Yes, sir.

Mr. Kurtz: And likewise, in April 11, 1955, an agreement

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for dismissal was entered into with Trans-northwest Company?

The Witness: Yes, sir.

Mr. Kurtz: And on April, 1955, your initial financing for Pacific was completed—about that time?

The Witness: I think, if I remember the date, it was May 4 when we closed. Our closing date was May 4, but it was right at that date; yes, sir. Early in May; yes, sir.

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Mr. Kurtz: Mr. Fish, at this time I would like to take up a little bit more in detail your competition with the El Paso Natural Gas Company for gas.

The Witness: Yes, sir.

Mr. Kurtz: And I call your attention to—strike that. Going back to 1952, you wrote a letter as Chairman of

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Board of Pacific Northwest to Mr. N. Henry Gellert, President of the Seattle Gas Company, and I ask you if this does not sound familiar:

> "Maguire Gas has resolved itself into a real battle between ourselves, El Paso, and Mountain Fuel. We need it to hold the Salt Lake City market and the Salt Lake City market adds to the project. I wish you folks up there in your country would realize the competitive si' tion on natural gas.

"Just to give you a general slant on it, we have strong competition today from El Paso, Mountain Fuel, and Colorado Interstate for any and all gas in the San Juan Basin and in the States of Utah and Colorado, with El Paso and Colorado Interstate offering two cents per thousand more than we."

Do you recall writing that to Mr. Gellert of the Seattle Gas Company?

The Witness: Yes, that rings a bell. I remember various letters and correspondence I had with him because I didn't think those people up there realized what we were facing in trying to wrap up a gas supply for that market.

Mr. Kurtz: Well, the facts as I have stated in here existed at that time, did they not?

The Witness: Yes.

Mr. Kurtz: And on September 18, 1952, you wrote a letter

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to Mr. John A. Maguire, President of the Three States Natural Gas Company, in which you stated:

"We have discussed and it is agreed that the location of the gas reserves owned and controlled by you in the Clear Creek Field are readily marketable in the Salt Lake City area. It has been discussed and it is understood that the stockholders of Three States and/or others have considered constructing a pipeline from the Clear Creek Field to the Salt Lake City market and have formed a company for this purpose, Utah Natural Gas Company, who has pending a permit for such pipeline system with the Public Service Commission of Utah.

"Our company desires to serve this market in addition to the other markets which it now has committed to it. In consideration of the stockholders of

Utah Natural Gas Company abandoning its plan to construct such pipeline system and the sale of gas by Three States Gas Company to us as set forth herein, Pacific Northwest Pipeline Corporation agrees to sell to the stockholders of the Utah Natural Gas Company or their assignees 25 per cent of the present authorized stock of Pacific Northwest Pipeline Corporation."

There might have been more to your letter, but do

1155

you recall sending such a letter?

The Witness: I recall a letter along that general line; yes, sir.

Mr. Kurtz: Along that general line.

And on September 26, 1952, you wrote a further letter to Mr. John A. Maguire in which you set out a firm offer to buy the gas and outlined, I believe, the proposed construction of the Pacific project to start in that area by taking the Clear Creek gas to Salt Lake City and later extending the line to the South to the San Juan Field and North to the Pacific Northwest Area.

Does that sound familiar?

The Witness: That sounds familiar, and as I remember the deal at that time, John had to have—Three States basically needed the market. They needed to sell gas.

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Mr. Kurtz: I believe you stated on direct that your

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first agreement, that is, Pacific's with Phillips, was in June of 1952 in the San Juan Basin?

The Witness: I believe I said—I gave the young lady the copy, but I believe that is what I said, and it was right at that time; yes, sir.

Mr. Kurtz: And it was the Phillips arrangement that you had that made it possible for you at that time, to build the Pacific Northwest Pipeline project?

The Witness: Yes, sir. They gave us a big bulk of the acreage at that time and carried on development work, which made it possible to have a basic supply.

Mr. Kurtz: And thereafter, amongst other companies, you attempted to buy gas from the Skelly Oil Company, did you not?

The Witness: Yes, sir. We made contacts with Skelly and I believe with Stanolind, Colorado Gas and Oil, and several other companies who had acreage in that area.

Mr. Kurtz: And you informed Mr. Skelly back in December of 1953 that the officials of New Mexico and the Governors of Colorado and Wyoming were favorable to your project. Is that not a fact?

The Witness: I believe so.

Mr. Kurtz: And the reason that they were favorable to your project, it offered an alternative market to the producers for the sale of their gas?

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The Witness: Yes, sir.

That probably needs enlarging upon somewhat.

Mr. Kurtz: Yes.

The Witness: In other words, all of those producers wanted another market connected to their reserves.

Mr. Kurtz: That is right.

The Witness: And Pacific gave them that, inasmuch as it was an unserved market, so that there would be more development, more development all over the Rocky Mountain area.

We told that story; we sold it.

Mr. Kurtz: And the New Mexico Commission supported your application, I believe.

The Witness: Yes, sir.

(1157)

Mr. Kurtz: And you wrote several letters to Mr. Gellert of the Seattle Gas Company, and particularly one of August 27, 1952. I believe you had this to say:

> "I intend to personally stay right on top of the Maguire deal until we either have or have not made an agreement, as it is one of the most important aspects of the overall deal. In the meantime we are still closing in on negotiations on several other blocks of acreage in the San Juan Basin, although the situation there is really getting competitive, with both Kayser of El Paso and

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> Colorado Interstate laying really serious money on the line and paying prices for gas considerably higher than we have so far paid."

Do you recall such a letter?

The Witness: Yes, sir. I don't recall particularly that letter, but I do know that I wrote Henry many letters up there.

Mr. Kurtz: Yes.

The Witness: In other words, he was one of our important customers in the area. We were trying to keep him on our side of the fence.

At that time I did feel that the Clear Creek gas was important, inasmuch as geologists had represented it to be from a trillion and a half to possibly two or greater, and as I said previously, then it petered out to nothing, and at that time it looked very important, and I will say this: Had it turned out to be as great as some geologists estimated, it would have been a real asset for Pacific.

At it turned out, I was very happy that El Paso got it and we did not.

Mr. Kurtz: Yes, but in the San Juan Basin, Mr. Fish, what I have just stated existed, did it not, such as your

competition for gas with El Paso and Colorado Interstate, and that the two companies, El Paso and Colorado Interstate, were paying prices for gas "considerably higher than we have

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so far paid".

That particular fact existed, did it not, at that time?

The Witness: Well, I thought our price in the Basin was actually higher than theirs. Now, I can be wrong. Again, ours was one of these drilling deals, but I thought ours was a higher-price deal.

Mr. Kurtz: I was under that impression, too.

The Witness: I think we paid more.

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Mr. Kurtz: Hasn't this competition in the San Juan Basin resulted in both you and El Paso bidding for the same blocks of gas in certain instances? Is that not correct?

The Witness: In the majority, I would say that El Paso was not even considered by the producers on the majority, the great majority, and I would say in the San Juan Basin that we got at least 90 to 95 per cent of our gas reserves.

I am talking about Pacific. In the San Juan Basin they were non-competitive between El Paso and ourselves. In other words, producers, every single one of them, gave me that gas.

Now, there was some acreage on the fringes, little blocks that we picked up that probably we were competitive.

Mr. Kurtz: Do you remember the Skelly Oil Company?

The Witness: As I remember it, I don't remember. I

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knew old Bill Skelly. He was my friend, and El Paso might have come in the door, but I didn't even know they were even looking at it. I mean, Old Bill was a good friend of mine.

(1166)

Mr. Kurtz: All right.

The Witness: And I got that deal, and the same way with all the rest of them. But I would say on 90, 95 per cent of that acreage down there there was no competition because El Paso had their bailiwick—we were over on the east side of that Basin and everybody committed to us and backed us.

Mr. Kurtz: You mean to say there was no competition in the San Juan Basin for the majority of the gas that you bought? Is that what you are saying?

The Witness: I am saying for the 90, 95 per cent of the reserves.

Mr. Kurtz: Well, how do you account for these——

The Witness: We were still trying to get a lot more.

Mr. Kurtz: How do you account for these letters to Mr. Gellert, then, in which you said that there was active competition in the San Juan Basin for gas between your company and El Paso?

The Witness: There was because we wanted more.

Bear in mind this, Mr. Kurtz, that that acreage, when we first had it—I think there were only maybe three wells drilled on it. Now, Phillips went in there and in a year or a year and a half they drilled about $9 million worth of

1167

wells. Other companies were doing it. And what we needed to make a showing before this Commission to get a certificate at that time, we needed deliverability. We needed wells drilled so we were out trying to buy anything in excess.

Now, we got very little in excess of the original acreage we had, but were out after it. But I am saying the resulting fact of the deal was that the big blocks of acreage were committed by—well, it was Stanolind, Phillips, Skelly, Colorado Oil and Gas, and a few others.

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Mr. Kurtz: Do you know why Phillips never sold their gas to the El Paso Natural Gas Company?

The Witness: I think so.

Mr. Kurtz: Why?

The Witness: Mainly what they wanted was another market connected to it, and when we came along and offered an unserved market in that area, that was their incentive to deal with us. And then I believe we gave them a little better price, a little better price, more money, but market was the whole thing.

Now, I think that was very true of all of the other reserves off our pipeline, the various fields I previously mentioned. The reason they dealt with us, we could offer them a market, an unserved market that was available to be connected to the reserves.

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Mr. Kurtz: Mr. Fish, your desire to sell gas to California markets and particularly the Pacific Gas and Electric Company continued right up until the time of the stock transfer from Pacific to El Paso, did it not?

The Witness: That is right.

Mr. Kurtz: Now, you referred to the fact of your offer to sell gas to the Southern Edison Company and at the time you were negotiating this sale, they were also talking to the El Paso people, were they not?

The Witness: I did not know that.

Mr. Kurtz: You did not know that.

The Witness: No sir. Mr. Quinton when I contacted him and we got together on preliminaries, mentioned this morning, and then we went on to finally having a deal with them, it was agreed we would try to wrap together a deal but I didn't know El Paso——

Mr. Kurtz: The reason you couldn't wrap together a deal was because he could not secure the cooperation of the Southern California Company's support, is that right?

The Witness: And of P G & E, yes sir. It was the dis-

(1172)

tribution companies in California. He needed that support in order to make an economic feasible project, yes sir.

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Mr. Kurtz: Now, you mentioned the fact of the unique position of Pacific's pipeline. Did you ever give consideration—well, let us put it this way. In considering that unique position, does that place Pacific in a position to render more economically the transportation of gas, say, from Canada to the California markets than a new pipe line?

The Witness: I considered it so. And I still think so. I don't see how any pipe line to California markets from Canada can go through Pacific's territory and get down to any California market cheaper than what Pacific can render that service for in the northwest area.

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Mr. Kurtz: Now going back to your negotiations with the El Paso Company relating to the acquisition by El Paso, after the agreement of December 1954, at that time El Paso was making various studies, was it not, relating to the effect of any acquisition by it of Pacific's facilities?

The Witness: Let me see, that was before we financed the original project, I believe. '54 now?

Mr. Kurtz: Yes, at the end of '54.

The Witness: It was about that time, along about that time, and in the spring of '55 that we did have overtures from El Paso to us.

Mr. Kurtz: Overtures from El Paso?

The Witness: To Pacific.

Mr. Kurtz: And in February or March of 1955 El Paso sent one of its representatives to your offices in Houston, did it not, to get information relating to the Pacific Company?

The Witness: Yes, I believe so. It seems to me that most

of our negotiations at that time were in New York, and then we finally had a general meeting of the minds in New York—except for one thing.

Mr. Kurtz: Yes. I am not talking about your executive group, but representatives were sent to Houston for information——

The Witness: I imagine they did, yes, sir, because they were making us a proposition.

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Mr. Kurtz: And do you recall, or do you know, what El Paso had in mind at that time to do with Pacific Northwest Pipeline so far as operating its facilities is concerned?

The Witness: I know what they told me.

Mr. Kurtz: What was that?

The Witness: Well, they offered us a proposition where we would agree to a 7(c) proceeding here before the Federal Power Commission, and on that basis that they would give us, let's see—then we would have a stock exchange. What they wanted to do basically was merge it in.

Mr. Kurtz: What I have in mind was the physical operation of Pacific, such as the movement of Canadian gas over through the Colorado Interstate system, and the movement of San Juan gas entirely through the Topock California line.

The Witness: Well, on that point of acquisition, that was acquisition by El Paso—that is the basic thing, isn't, that we are talking about?

Mr. Kurtz: That is right.

The Witness: As I remember it, they did not divulge just how they would operate it.

Mr. Kurtz: I see.

Presiding Examiner: What did you say, Mr. Fish, did not divulge what?

The Witness: Just their method of operation. In other words, we never got into that point. It was a matter of

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whether Pacific wanted to go through a 7(c) proceeding and hang the Pacific deal up on a bench until the 7(c) could be obtained, and we at Pacific could not see it, could not agree to it.

Mr. Kurtz: But a definite proposition was made to you on March 24 of 1955 as reported to you by C. R. Williams of your company, was it not?

The Witness: I know during that spring, be it one day or the other, yes, we had a definite proposition.

Mr. Kurtz: In fact, after that there was a draft of a stock purchase agreement, I believe, all of these things——

The Witness: There could have been, yes. We had extensive negotiations at that time.

Mr. Kurtz: And in these negotiations that you had in the spring of '55, El Paso would make you an offer, and you in turn would also make El Paso an offer, would you not?

The Witness: We had quite a little bit of horse trading going on at that time, yes, sir.

Mr. Kurtz: And finally El Paso made the statement they were through?

The Witness: Yes, sir.

Mr. Kurtz: And the next day, or at that same time, they decided maybe they better get together again. That is the way it went, isn't it?

The Witness: It was kind of a see-saw affair. But

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basically what it hinged on was a 7(c) that we at Pacific would not agree to, and El Paso in turn insisted on a 7(c).

Mr. Kurtz: Yes. Finally on December 14, 1955, you received, I believe, the following letter from Mr. Paul Kayser of El Paso.

At this time, Mr. Examiner, I would like to have marked for identification a letter dated December 14, 1955, ad-

dressed to Mr. Ray C. Fish, Chairman of the Board, and Mr. C. R. Williams, President, Pacific Northwest Pipeline Corporation, New York, New York.

Presiding Examiner: Who was the writer of this letter?

Mr. Kurtz: Mr. Paul Kayser, I understand——

Presiding Examiner: Let that letter as described by Mr. Kurtz be identified as Exhibit No. 372.

(The document referred to was marked for identification as Exhibit No. 372.)

Mr. Kurtz: Mr. Fish, have you read the Exhibit 372?

The Witness: Yes, sir.

Mr. Kurtz: And did you receive this letter from Mr. Paul Kayser?

The Witness: The 5 for 9—I know we had such an offer. Mr. Kayser is here, is it all right if I ask him? As far as I know I received it, and as far as I know he wrote it. It could have been, although I cannot say for sure. I know this reminds me of one of the deals again.

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Mr. Kurtz: And if I understood you correctly on your direct examination, the reason that you were insisting on a stock transaction was to be sure that it would be a tax-free exchange, is that not correct?

The Witness: That is on the deal that we made on November something, 8 I believe it was, 1956.

Mr. Kurtz: Yes.

The Witness: We made it.

Mr. Kurtz: You always had that in mind, did you not?

The Witness: Yes, sir.

Mr. Kurtz: That it had to be tax-free?

The Witness: Tax-free exchange.

Mr. Kurtz: And why was Mr. Kayser insisting that the matter be, the application be, filed with the Federal Power Commission?

(1183)

The Witness: Well, he wanted a merger. He wanted to merge the assets of Pacific into El Paso in order to have a better over-all operation, I imagine.

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Mr. Kurtz: Mr. Fish, on February 22, 1956, I believe there was a special meeting of the Board of Directors of Pacific in which you were present, in which there was a discussion of the exchange offer, and I believe that at that meeting a preliminary investigation had disclosed that there would be considerable opposition—it was stated in the resolution, rather—that there would be considerable opposition on the part of the Federal Power Commission to such a merger, and opposition had also been indicated from the market areas of California and from the Pacific northwest, and it was felt that the corporation should not incur opposition from its markets at the present time when the corporation is greatly dependent upon their support. In substance were such matters discussed at this particular meeting? I do not have your minutes.

The Witness: Well, I would say straight through on the many offers we had from El Paso, and again always like in this letter right here, of December 14, the whole thing was hung on 7(c), and it was the general opinion of myself and Williams and other officers and directors of the company that we could not afford to risk the animosity of our customer companies by having a 7(c) because until the 7(c) case could be decided by the Federal Power Commission we were tied up on financing, on expansion, on operation, and no one would know where we were going. I mean, it would be one of these

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indefinite things because on that basis Pacific, we, would still be owning the company, and El Paso would be owning the company, and we would be just status quo. And basically

it was that type of discussion that we had at our various Board meetings, that we could not risk jeopardizing, particularly, our market.

Mr. Kurtz: And that is the opposition that you had reference to?

The Witness: Yes.

Mr. Kurtz: Well as far as the market area, but what was the reference to the fact that there might be considerable opposition from the Federal Power Commission? What preliminary investigation was that about?

The Witness: Well, I did not know that we considered that there would be opposition from the Federal Power Commission. In fact, I was always of the opinion maybe the Federal Power Commission would approve it, that by putting the companies together it might be in the public interest, and much better than operating as two separate lines. That was my own personal opinion.

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Mr. Kurtz: Now you mentioned that there were certain benefits from the acquisition of Pacific by El Paso, and I have five noted. But can you be a little more definite than that? Can you give me any dollar amounts that might flow from these benefits that you have listed?

The Witness: I do not believe I can give you any dollar amounts, but I can give you the general overall basis of my consideration.

Mr. Kurtz: Yes, but I wanted something more definite. Well, let me ask you this, did you have any studies made

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relating to the savings?

The Witness: No detailed engineering or such studies made. What we did was make general calculations.

Mr. Kurtz: You say general calculations?

(1187)

The Witness: General calculations of bringing in, by particularly our Rocky Mountain gas that was becoming at that time available to us, in amounts over and above what Pacific could handle. Now there was a place that we must move it. Should it move up the line; should it move down the line. Now going on either the merger, exchange of stock, the consolidated companies, we considered that that gas, particularly in the Rocky Mountains, could be moved more economically down through the existing facilities of Pacific with El Paso——

Mr. Kurtz: You mean south?

The Witness: Move south. The background of that being, when we started out, I believe—this was back in '52 and '53—we were trying to support to this Commission between two and a half and three trillion cubic feet of gas. During the succeeding period of three years or more, Pacific being built, the gas reserves that became available to Pacific—now that was the gas from Canada, and the additional gas that was found in the Rocky Mountains—we found ourselves, in about '56, in the year '56, about the middle of that year, I personally could see, instead of three trillion we had a potential of eight to 10 trillion cubic feet available.

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And at that time it was very clear that we needed more markets.

Now where were we going to get the markets? They could be in either direction. And typical of what we attempted to do in obtaining the markets, I made that deal personally in Chicago, I had the Chicago market, not Colorado Interstate, and Mr. Oates—I found gas for him in Texas-Illinois—in turn asked me would you put together the picture. I considered at that time it would be very difficult to justify all the gas, and support all the gas we needed, and so in turn we were not interested in heading out for Chicago. We made that three-way deal, Colorado Inter-

state, Natural Gas Pipeline and Pacific, each one threw something in the pot, in exactly the same order that we did with Mr. Kayser in the fall of '54, December, '54, endeavoring to sell some of the Canadian gas to the California market. In other words, we were trying to work within the facilities that were available to all the companies with the minimum amount of construction of new facilities to cut out the expense of duplication of facilities. And that was our main objective straight through in the studies, in the preliminary or casual studies we made.

It was obvious to us that if we did tie the two systems together, with El Paso being connected to the California markets, Pacific being connected to the Pacific northwest markets, to the Canadian reserves, and then looking at

a map and treating all the markets of the western part of the country as one, it would probably be in the public interest and would require less duplication of facilities to serve all those markets from a common integrated system.

Now from the stockholders, being a stockholder and director of Pacific at that time—and frankly we had a lot of pride in our company, Pacific, we created what we consider the unique vehicle and one of the best pipe lines I had seen—but we could see greater advantages in the overall of putting them together, than this thing of just duplicating facilities to try to reach the same market. And it was for that basic reason that myself, as a stockholder and as a director, chief executive officer of Pacific, finally decided that we could accomplish more for the public as a whole on the basis that the market, after all, wrote the ticket, your market companies, your distribution companies, write the ticket in this business—in my book, as a pipeline man, particularly as a chap out creating a new pipeline. If you do not get that market to go along with you, you have no pipe line. And I tried to interest the California companies

with El Paso to jointly serve them. I tried to do it separately, and then I think, historically, since Pacific and El Paso got together in that November and made the deal—I think the record pretty much speaks for itself. Since then P. G. and E.

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have announced they want gas, they are going to build their own line. I believe El Paso has sold Southern California considerable volumes of gas. They still want more gas. They even, I think, back Transwestern. So it shows there was an extensive market out there, a market that needs to be served. But basically at that time Pacific needed more markets. We had the gas. Our supply situation had completely reversed itself.

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The Witness: Why, we most certainly could have financed a line, because any line that we would have undertaken would have had to have been economically feasible. Therefore we could have financed it.

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I have never entered into a contract that I have not or could not finance. Therefore I could have financed.

Mr. Kurtz: Yes. And even when you were negotiating for the sale of that gas to the California markets there was no doubt in your mind that you could finance that pipeline, was there?

The Witness: No, sir, because the type of contract I would have with my customer companies would be such on which I could finance.

Mr. Kurtz: That is right.

And did you at this time also discuss with your finance people your proposals to build lines to the California market?

The Witness: I believe our main investment house knew about it—Mr. Kiernan, of White, Weld, who is now a special partner of it.

I mean, I think we discussed it casually with him.

Mr. Kurtz: And did Mr. Kiernan at any time discourage you on the grounds you could not finance such a project?

The Witness: Not that I remember. In fact, there was not any doubt in my mind. It might have been hard to do, but again, it would be based on making a suitable contract with the market company that would make a line economically feasible, and then you can finance it.

Mr. Kurtz: Lots of financing is rather hard to do, is it not?

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The Witness: Sir?

Mr. Kurtz: Lots of financing is rather hard to do?

The Witness: Much of it. Our original line was very difficult.

Mr. Kurtz: And the original project of Pacific was not exactly easy, was it?

The Witness: No, sir, and that caused us much trouble.

Mr. Kurtz: And you also financed on very favorable terms did you not?

The Witness: Yes, sir.

Presiding Examiner: Favorable to whom?

The Witness: The pipeline company.

Mr. Kurtz: Pacific.

Presiding Examiner: I just wanted to make that clear.

Mr. Kurtz: In other words, your offers, so we understand each other thoroughly, Mr. Fish, your offers that you did make to the Southern Edison Company and also to the P. G. and E., the firm offers that you made to Southern California Gas, there was no doubt in your mind you could finance that project?

The Witness: I was absolutely sure I could.

Mr. Kurtz: Thank you.

Did anyone in your organization ever suggest to you that you would not be in a position to finance the project, sir?

The Witness: Well, I imagine by that you mean possibly

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Mr. Silloway and some of the other staff members?

Mr. Kurtz: Anyone.

The Witness: I do not remember about it. I pretty much, you know, just went along and decided what was good to see if I could get a contract, and then went ahead and financed it.

Mr. Kurtz: Now, as to the future financing of Pacific, had it remained an independent company, is there any doubt in your mind that you could finance the necessary capital to continue your programs?

The Witness: Again let me preface my remarks by saying this, that I, you might say, left after active management along about the end of 1956.

Mr. Kurtz: I am talking about—I beg your pardon.

The Witness: So now I do not want to second guess for myself or anyone else, because my remarks are after I left the company.

Mr. Kurtz: You were still Chairman of the Board, though, were you not?

The Witness: Yes, but up until March, when I did resign officially——

Mr. Kurtz: And a Director?

The Witness: Yes, I am still a Director.

Mr. Kurtz: All right.

The Witness: But I would say that Pacific would have had to have taken steps to correct its financial condition,

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which it could have done—I think various avenues were open—and then it could finance. And I have never seen one

of these pipelines yet, one of these new pipeline projects being created that did not have some difficulty in their initial years. In fact, I will even go beyond pipelines. It seems like most every business has crisis after crisis.

But work twelve more hours a day and you get out of it.

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Mr. Kurtz: Mr. Fish, relating to your contract with

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Specialty Products Company, at the time that you entered into that contract was there any question in your mind that they would not be able to perform under it?

The Witness: Well, Specialty was formed by Calor, and as I remember the deal while it was in the name of Specialty, I believe the performance of the contract was guaranteed by Calor Gas Company. Now I had known of them for a number of years, and I thought they could perform. Now they do a marketing job, exactly like Warren Petroleum, like Phillips Petroleum Company, like a fellow by the name of Frank Carpenter in Minneapolis, Anchor Petroleum, that market or job light hydrocarbons, protane, butane and natural gasoline and such stuff.

Mr. Kurtz: Well under your contract with Specialty, in the event that they fail to take, you have the right to market those products yourself, did you not?

The Witness: If they failed to take?

Mr. Kurtz: Yes.

The Witness: I believe we did. I imagine so. I do not remember the details of the contract. I remember the overall of the deal very well.

Mr. Kurtz: Well what you did was to buy yourself out of a bad contract, is that it?

The Witness: Well, that needs a lot of thought now.

Mr. Kurtz: All right.

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The Witness: When we came up and started making some products, the bottom had gone out. What I mean, the general index on natural gasoline, I think, was down some 85 to 63. We knew the prices were off about 25 per cent. And under that contract they could take it or they could have us flare it, or they could do anything with it and try to sell it. And as I remember the contract, it was at the end of the year of operation, and then they could make the final settlement with us. And if it was lower than the 4¼ cent average, then where were we going to get our dough from? It would work a hardship on us. So we just decided that one of the fundamental things in the long range was for us to get that contract back, get it back from them and go ahead and make plans to upgrade those products on a long range basis, where it was year by year under their contract basis. Further, on the basis, it would not have mattered whether that contract had been Calor or the Specialty, they were one and the same, or had been with Phillips Petroleum or with Warren Petroleum or any of the rest of these marketing companies. Personally, I have been up there, in the middle of it, where products went to pieces once before like that, the same products, where Warren Petroleum we adjusted their contract downward and gave up on it. With this company we wanted to get rid of them, very frankly, we wanted them out of it and go our own way. Now you might say: Why did we enter into the contract to begin with. I would say

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the pressure was on us while we were endeavoring to get a certificate to show that we could make such a contract. I mean, the pressure from, as much as anyone, our market companies and from our opposition, could we market those products. And so we went out and we made a contract to prove that we could.

Mr. Kurtz: I gather from what you said that you bought your way out of an undesirable contract?

The Witness: That might be it. That is one way of putting it. We used our best judgment to go ahead and play it long range.

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Mr. Standley: Mr. Fish, you stated that the New Mexico Commission and the officials generally supported your application. Now, you are a salesman of note, I think we can all agree, and you were at your promotional best at the time you were selling Pacific Northwest, were you not?

The Witness: I had to be.

Mr. Standley: What did the New Mexico Commission go along with your position on, what was their support of Pacific Northwest application based on?

The Witness: I would say what they wanted was another market, to get faster development of the New Mexico reserves.

Mr. Standley: It was not any overwhelming enchantment with Pacific Northwest or Mr. Fish—El Paso could have done the same thing?

The Witness: That is right. But I think the general feeling was that the California companies wanted that held back, the development of the San Juan Basin—if I remember our discussions out in New Mexico—whereas we would offer another market, an additional unserved market to bring in that would be fresher and virile and active and dynamic.

Mr. Standley: But any other company would have offered

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that to the New Mexico Commission, would it not?

The Witness: Oh, I think so; yes, sir.

Mr. Standley: And at that time, in your promotional fer-

vor, you, of course, represented this to be an extremely financially sound company, did you not?

The Witness: Yes, sir; it is still.

Mr. Standley: Well, at least the impression was that you would have no difficulty with markets?

The Witness: That is right.

Mr. Standley: Now, Mr. Fish, you stated that you had purchased about 90-some-odd per cent, 94 per cent or 95 per cent; in that San Juan purchase you had no competition.

Now, you actually overbought some in the San Juan, didn't you? At the time you left the company you were having difficulty building gathering systems to all your gas contracts, weren't you?

The Witness: We had a lot of acreage that takes time to develop.

Mr. Standley: And at that time you had not fulfilled what at least the producers thought were commitments?

The Witness: Well, at the time I left the company they had given us relief, temporary relief, and let us string it out a little bit longer.

Mr. Standley: But you had to ask for temporary relief on a couple of occasions?

The Witness: Yes, and they had done it. All the producers went along with us. They knew we were using our best efforts and doing the best we could, and they assisted us.

Mr. Standley: But at least, whether it be because of financial difficulty, certainly there was some reason why you had not at that time built gathering systems to all your acreage?

The Witness: Well, we had not developed all the acreage.

Now, as we developed, we did build a gathering system down, and then in turn with other acreage we made a deal with El Paso whereby they would gather, render a service

for us. And we did, we had operating agreements with El Paso in the Basin.

Mr. Standley: And El Paso gathered a great deal of your gas?

The Witness: Yes, El Paso gathered so that it would save us duplication of gathering lines.

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1209

Mr. Furbush: Then it is my understanding that sometime in 1954 you made a contract with Westcoast Transmission Company for the purchase of Canadian gas at the border?

The Witness: In 1954 we did; yes, sir.

Mr. Furbush: At that time, had you made a market survey to determine that you needed that gas in the Pacific northwest area?

The Witness: Well, all the way through we knew about what the market would stand in that area.

Well, I mean, we knew generally about it, because we had surveyed it a number of times. Yes, we knew about what it would take.

Mr. Furbush: Well, what I am getting at is: at that time, apparently, you placed yourself in the position where you had something in the neighborhood of eight trillion to ten trillion in the gas reserves, and you had a market in the Pacific northwest which would have been satisfied with the reserves which you were getting from the San Juan Basin, somewhere in the neighborhood of two trillion to three trillion, and I would just like to find out what market you had in mind at the time you entered into that contract with Westcoast Transmission Company.

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The Witness: Well, that was very obvious.

Simultaneously, entering into that contract with Westcoast, we had a three-way deal: El Paso, Westcoast, Pacific.

(1210)

I mean we had a tri-party deal. We sold to El Paso at that time 250 million a day.

Mr. Furbush: To take the gas where?

The Witness: Oh, let me see—we were delivering it to them at—at that time the point was Mountain Home. So, we sold 250 million.

Mr. Furbush: For the purpose of taking it to California?

The Witness: Yes. But it was a tri-party deal.

Mr. Furbush: So it was your estimate that you could transport that gas through your system to the El Paso system cheaper than it would have been to construct a direct line from the Canadian Border connected with Westcoast?

The Witness: Very obviously it could be.

There is no question in my mind that you cannot have duplicate facilities and do it cheaper with one than you can the other.

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Mr. Letton: Referring to your discussion regarding the arrangement that you entered into with Southern California Edison Company in July of 1956, I believe you stated that in order to make that transaction go that the cooperation of the California distribution companies was required.

Is that right?

The Witness: Yes, sir.

Mr. Letton: And just what did you mean by "cooperation"? What sort of cooperation did you have in mind, or did you hope for?

The Witness: Well, as I remember, in my negotiations and my agreements with Harold Quinton, who is president of Southern California Edison Company, it was agreed that Pacific would have to have an over-all market of about three hundred million cubic feet of gas per day in order to even get the thing to make it anywheres near economically feasible.

A good part of that gas they could use in their facilities, but it would need to be delivered to some of the various distribution companies, so that they in turn could back off gas to his plants.

In other words, in our negotiations, I told Mr. Quinton in my opinion the deal would not be economically feasible, to run a new system complete to all of the plants. It would be too costly. And, therefore, the Southern California companies,

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who are connected to the various plants of Edison would have to participate in some manner.

Mr. Letton: Do you recall what the estimated price of the gas was to Southern California Edison Company under their contract of July 30, 1956?

The Witness: It went all the way from 45 to 50 cents, as I remember, depending on the point of delivery and the volume.

Mr. Letton: I believe you stated that you left the negotiating with the California distribution companies to Mr. Quinton.

Is that right?

The Witness: Completely.

Mr. Letton: You have no knowledge of what form those negotiations took other than the final outcome; is that right?

The Witness: That is right.

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Mr. Shannon: Mr. Examiner, there have been frequent references to the Salt Lake City litigation. I think that in

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order to have this picture up to date I will ask at this time that there be copied into the record as though read the order

which the Judge entered on October 13, 1958, in that proceeding which is entitled "United States of America v. El Paso Natural Gas Company and Pacific Northwest Pipeline Corporation: Civil No. 143-57."

I could read it into the record, it is quite short.

Presiding Examiner: I wonder if you could give me that one copy. You seem to have others. Then, let the reporter return it to me after it is copied into the record.

Now is there any objection from anyone that this request it be copied into the record be granted? Is there any objection? Hearing none I will assume there is no objection, and it will be copied into the record, at this point.

If you will furnish it to the reporter, it will be at this point copied into the record, and then I will request the reporter to return it to me.

"IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF UTAH

Central Division

Civil No. 143-57

UNITED STATES OF AMERICA, *Plaintiff*,

v.

EL PASO NATURAL GAS COMPANY and PACIFIC NORTHWEST PIPELINE CORPORATION, *Defendants*.

ORDER

1218

"Defendants' application for a continuance of the trial of this action filed October 2, 1958, came on for hearing before the Court on October 10, 1958.

NOW, THEREFORE, after oral argument and full consideration of said application and of the letter to the Chairman of the Federal Power Commission from the Chief of the Antitrust Division of the Department of Justice dated

October 6, 1958, and of the letter to this Court from the Chairman of the Federal Power Commission dated October 7, 1958, the application of the defendants is granted, and the trial of this action is hereby continued until the final determination by the Federal Power Commission of the applications now pending before it in Docket Nos. G-13018 and G-13019. It is further provided and ordered that the pretrial conference heretofore fixed for November 3, 1958, and the time for defendants to answer the interrogatories heretofore propounded to them by plaintiff are hereby continued until such dates as this Court may hereafter designate.

DATED: October 13, 1958.

WILLIS W. RITTER, Judge"

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1232

Paul Kayser

was recalled as a witness and, having previously been duly sworn, was examined and testified further as follows:

Mr. Kurtz: Mr. Examiner, before taking up the examination of witnesses for the applicant, there is certain material that has been furnished to the Commission, and I would like to have it identified as an exhibit by reference.

This may save—I hope—time in the examination of the various witnesses.

And I ask now, at this time, that in the Sixth Supplement filed by the El Paso Natural Gas Company, which was received May 21, 1958, that Tab Number 6 of Book I be identified.

1233

Tab 6 of Book I is a descriptive listing of schedules submitted—As stated here, it is entitled:

"Descriptive Listing of Schedule Submitted in Response to Item 7 of the Commission's Letter Dated

(1233)

May 9, 1958, in Regard to the Ruling of the U. S. Internal Revenue Service Concerning the Treatment of the Acquisition by Applicant of Pacific Northwest Common Stock and Representations Made by Applicant re Applications for Listing of Common B Stock in Filings with the Securities Exchange Commission Involving the Common B Stock."

Presiding Examiner: Under the rules, you are asking that it be made a part of this record by reference to it——

Mr. Kurtz: To the Commission's files.

Presiding Examiner: (Continuing)—as a part of the Commission's files, and not as a part of the record in any other case.

There are two rules, you know.

Mr. Kurtz: That is right.

Presiding Examiner: And you are asking as part of the official files of the Commission.

Mr. Kurtz: That is right.

Presiding Examiner: Any objection, gentlemen?

(No response)

Presiding Examiner: Let me have that again, Mr. Kurtz.

1234

Mr. Kurtz: Maybe it would be better if I handed it to you.

Presiding Examiner: I think it would indeed.

I would like to have a copy, if you can get it somewhere, from someone, if it is going to be important in this case.

1235

Mr. Grenier: Mr. Kurtz, was this Book I generally distributed and made available at the last hearing, so that this would be a normal part of what the rest of the parties in this case would have received at the last hearing?

Mr. Kurtz: It was filed as the sixth supplement by El

Paso to their application and served on all parties at that time.

Mr. Grenier: Thank you.

Presiding Examiner: Now so that we may state this accurately, all that is contained within paragraph 6.

Mr. Kurtz: That is correct.

Presiding Examiner: There is a good deal there, gentlemen. Is there any objection?

Remember, speak now or forever hold your peace. Or, if you want time to examine this—of course applicants have familiarity with it, I am sure, but there is a lot of material in here that is going to become evidence.

Mr. Shannon: We haven't any objection, Mr. Examiner.

Mr. Payne: No objection.

Presiding Examiner: Has anyone else any objection?

I just did not want someone to say later that they did not have a chance to object to it.

That is identified as item A-3 by reference to it.

(The document above referred to was identified as Item A-3 by reference.)

1236

Mr. Kurtz: And I now offer it, of course.

Presiding Examiner: Is there objection to it being received in evidence? It is received in evidence.

(The document above referred to previously identified as A-3 by reference, and was received in evidence.)

Mr. Kurtz: In the same volume, I ask there be given another item number by reference Schedule 7-B, which is a map showing the location of El Paso's gas acreage acquired in Canada.

Presiding Examiner: And that is shown in this same bound book of information under tab 7, or Schedule 7, and is identified as Schedule 7-B, and is so marked in this file of the Commission.

(1236)

Now what I have before me, I am assuming, Mr. Kurtz, to be the official file of the Commission?

Mr. Kurtz: No, that is not the official file, but it is a copy of the official file of the Commission. Wait a minute, I do not know whether you would call it or not, but it is one of the 15 volumes that they submit.

Presiding Examiner: Well one has to be filed officially, and the others are work copies.

Mr. Kurtz: That is right, this is a work copy.

Presiding Examiner: But the official file with the formal file——

Mr. Kurtz: It would be identical.

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Presiding Examiner: —is identical with it?

Mr. Kurtz: That is my understanding.

Presiding Examiner: All right, then, 7-B will be identified as Item B-3.

(The document above referred to was identified as Item B-3 by reference.)

Mr. Kurtz: And I now offer the item.

Presiding Examiner: Is there any objection to it as described by Mr. Kurtz? If not, it is received in evidence.

(The document above referred to previously identified to as Item B-3 by reference was received in evidence.)

Mr. Kurtz: Likewise, in the same volume there is a tab number 8—you have that book number 1—which sets forth all agreements between El Paso Natural Gas Company and Pacific Northwest Pipeline Corporation, which was, of course, submitted in response to the Commission's request. I ask that that tab number 8 be given an item number.

I might say, Mr. Examiner, this will save a great deal of time, because I do not want to go through all these matters with Mr. Kayser.

Presiding Examiner: Now do you offer that?

Mr. Kurtz: I do offer it.

Presiding Examiner: Any objections from anyone?

It becomes a part of this record by reference to it in the official files of the Commission as Item C-3.

1238

(The document above referred to was identified as Item C-3 by reference, and was received in evidence.)

Mr. Kurtz: I ask that there be given an item number by reference a stock list of Pacific Northwest Pipeline Corporation which was a part of the second supplement filed by El Paso Natural Gas Company in response to Commission's letter of November 7, 1957. I have a copy of that document here, Your Honor.

Presiding Examiner: It so happens that I recognize it as something which I have a copy of in the file that was given to me when the case was assigned to me. So I shall mark this for identification as Item D-3 by reference to it in the files of the Commission.

(The document above referred to was identified as Item D-3 by reference.)

Mr. Kurtz: And I now offer it in evidence.

Presiding Examiner: Any objection? It is received as Item D-3.

(The document above referred to previously identified as Item D-3 by reference was received in evidence.)

Presiding Examiner: Did you state, Mr. Kurtz, in response to a question, I think perhaps from Mr. Bennett, or some counsel, that the first book of exhibits you thought had been furnished to all parties? Did you not make that statement? I am assuming that these interventions were applied for or

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granted early in this proceeding much before the hearing, and that these exhibits or requests from the staff to make the supplements, I am assuming, would be sent to the parties. I know I have them with my file.

Mr. Kurtz: I was under the impression that when they were filed with us in response to the Commission's letter, these items that I have mentioned were also served upon other parties that have filed petitions to intervene.

Presiding Examiner: Well I am only thinking of the intervenors having the use of them when it comes time for briefing. Someone should make them available to the parties.

Mr. Grambling: Mr. Examiner, I think you will find a certificate of service on the back of each one of those instruments Mr. Kurtz is referring to.

Presiding Examiner: Then that assures me they have been served upon all the parties, and that is all I want to know.

Mr. Kurtz: There is a certificate of service on these.

Presiding Examiner: I was only giving the boys an opportunity to assert themselves, if they wanted to.

1240

Mr. Kurtz: I will ask that the next item number by reference be given to Tab 4 of the Seventh Supplement to the original application in Docket Number G-13019, filed by the El Paso Natural Gas Company on June 5, 1958.

The tabulation is entitled:

"Tabulation of Investments of Pacific Northwest Pipeline Corporation at December 31, 1957."

Presiding Examiner: I think I have sufficient description of it from your——

Mr. Kurtz: I now offer in evidence the exhibit by reference.

Presiding Examiner: It will be identified as Item E-3 by reference to it, and, your having offered it——

Is there any objection to its being received in evidence?

(No response)

Presiding Examiner: Hearing none, it is received in evidence.

(The document above referred to, previously identified as Item E-3 by reference, was received in evidence.)

Mr. Kurtz: I ask that there be given the next item by reference to the rate filing made by El Paso Natural Gas Company, which was filed June 28, 1957, in Docket Number G-12948——

This is a pending rate matter before the Commission in which El Paso seeks increased rates.

Presiding Examiner: Now you are asking that the tariffs

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themselves——

Mr. Kurtz: No, the filing, the rate increase filing.

Presiding Examiner: Including all supporting data? and so forth?

Mr. Kurtz: That is right.

I have a copy of it here. It is available.

Presiding Examiner: Is there any objection?

(No response)

Presiding Examiner: They are identified as Item F-3, the rate filing of June 28, 1957, which, by order of the Commission, tests of the lawfulness of those rates have become Docket Number G-12948.

(The document above referred to was identified as Item F-3 by reference.)

Presiding Examiner: Do you offer it, Mr. Kurtz?

Mr. Kurtz: I do offer it.

Mr. Von Huben: May I ask Mr. Kurtz why he is submitting that?

Mr. Kurtz: It contains the financial information at that time relating to the El Paso Natural Gas Company, and their contentions.

Mr. Von Huben: No objection.

Presiding Examiner: Does anyone else have any objection?

(No response)

Presiding Examiner: It is received in this record by

reference to it as the formal file indicates of which the number was given by Mr. Kurtz.

(The document above referred to, previously identified as Item F-3 by reference, was received in evidence.)

Presiding Examiner: Now, I am thinking about the parties being able to have access to it.

Mr. Kurtz: Not only the formal file will they have, but the copy I have will be available to anyone who wants to look at it.

Presiding Examiner: Yes, but not in California and Washington and places like that.

Mr. Kurtz: No.

Presiding Examiner: And that makes it very difficult at such a time as they go to brief a case.

Well, we can let that situation take care of itself. We can get the information to them somehow if they want it, the lawyers want the information, or want to know what the form is. It has to be taken care of some way, because I do not want a man coming in from California just to see what is in the record of the Commission.

Mr. Kurtz: Most customer companies, I believe, are all served with copies of it, too, Your Honor.

Presiding Examiner: Well, I am just——

Mr. Kurtz: I just mention that because of your concern.
Presiding Examiner: I am just giving the people present,

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and lawyers, opportunity to stand up on their hind legs and talk about it if they want to. If they are not interested, it is all right with me.

Mr. Kurtz: Likewise, Mr. Examiner, I ask that there be given the next item by reference the rate filing by Pacific Northwest Pipeline Corporation. It was filed on August 6, 1957, and was given Docket Number G-13202.

Now, likewise, this filing is still pending.

Presiding Examiner: Now, that was Pacific Northwest?

Mr. Kurtz: That is right.

Presiding Examiner: Let that be identified as Item G-3 by reference.

(The document above referred to was identified as Item G-3 by reference.)

Mr. Kurtz: And I now offer Item G-3.

Presiding Examiner: Any objection?

(No response.)

Presiding Examiner: Item G-3 is received in evidence.

(The document above referred to, previously identified as Item G-3 by reference, was received in evidence.)

CROSS-EXAMINATION

By Mr. Kurtz:

Q. Mr. Kayser, as I recall, you took up briefly some of the history of the El Paso Natural Gas Company. Let me ask you, as I understand it, the company was

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organized for the immediate purpose of bringing gas from Lea County, New Mexico, to the area in and around El Paso, Texas? A. That is right.

(1244)

Q. And its initial pipeline was approximately two hundred miles in length, with a delivery capacity of 36 million cubic feet of gas per day, and delivery of gas in the El Paso area was commenced in 1929? A. That is right, in June, 1929. The size of the pipe line was 16 inches, 450 pounds' working pressure.

Q. And as a result of subsequent extensions to the Douglas-Bisbee area and to Tucson and the Phoenix area in Arizona, and the construction of other new facilities, the company's pipeline system by 1946 included approximately two hundred miles of main and lateral transmission lines, including the entire mileage of multiple lines with a delivery capacity of somewhat over 150 million cubic feet of gas per day. Does that sound familiar? A. Well, the two hundred miles of main and branch delivery lines——

Q. Two thousand. A. Oh, I heard it as two hundred miles.

Q. I beg your pardon. Maybe I read it wrong. A. I think that is about right; yes. I know the delivery capacity is what you said: 150 million, roughly, a day, and I know where it went. I know the

1245

sizes, and I think that the mileage that you gave is undoubtedly correct.

Q. And then, beginning in 1946, the El Paso company undertook and made your expansion program which greatly increased the size and scope of its properties and operations and the volume of its business. The initial step in that program was the construction of a new pipeline system extending from west Texas and southeastern New Mexico to the Colorado River to provide for gas deliveries of up to 305 million cubic feet per day to Southern California Gas Company and Southern Counties Gas Company of California, and also to increase deliveries of gas in Arizona and other

areas previously served by the company by approximately two hundred million cubic feet per day. Does that sound familiar? A. The service to companies other than California by approximately two hundred million feet per day?

Q. That is right. A. By what date?

Q. You undertook this program in 1946. A. I do not think that—Did we increase the service to others which was then 150, and then, at that time, undertook to increase the service to others than California by 200 million more?

Q. No. No, by 20 million. Did I say 200?

1246

A. That is the way I understood it.

Q. I am reading from an old registration statement, Mr. Kayser, and sometimes my reading is not too accurate; but I will change that to approximately twenty million cubic feet of gas per day. A. We put in there in that program a sufficient amount of expansion to take care of the demands of the market other than California. At the time, we planned the building of a 26-inch line all the way from the Permian Basin to Topock—not Topock, but to a point near Blythe; and a 24-inch line from Dumas down to the Permian Basin. And that had what you described there. I do not remember the figure. I knew it was a relatively small number of million cubic feet a day for the old system, and the plan was for 305 million to California. That is right.

Q. And the deliveries of gas to the Southern California companies through such new system commenced on October 30, 1947, increasing by January of 1948 to 175 million cubic feet per day, and by February of 1949 attaining the initial contract maximum rate of 305 million cubic feet per day? A. Yes, sir. That is my memory. We reached the 305 much quicker than we had intended, and, as you will notice by the contracts, it was not contemplated that the 305 million would be reached as quick as

February, 1949. But we did.

Q. And your next major expansion was the construction of your loop line projects which was initiated in 1948 and was in large part completed by the end of 1950. That project involved the construction of facilities designed to provide capacity for the delivery from the Permian Basin area of an aggregate of 430 million cubic feet of gas per day, including 100 million cubic feet per day to the Southern California companies in addition to the 305 million initial maximum mentioned above, 250 million cubic feet per day to the Pacific Gas & Electric Company, and 80 million additional cubic feet per day to the companies' service areas in Arizona, New Mexico, and west Texas. A. Yes, sir.

Q. And you have continuously made large expansion programs for the El Paso system in meeting your market requirements; have you not? A. Yes, sir.

Q. And at the present time, the expansion resulted in total assets of the El Paso Natural Gas Company, after deducting your reserves for depreciation, as the 29th largest United States non-financial corporation? Is that not correct? A. I have not made that calculation.

Q. I hand you the news letter from National City Bank

for September, 1958, and I made a little tabulation on there. It shows the size of your company, and I have tabulated that to where you range as 29. A. On those assumptions, I think that must be correct, but I have not made any such calculation myself. I would expect the National City Bank to be correct in their figures, and I would expect you to be correct in yours.

Q. I hope that I always am. If at any time I make one that is not, I certainly want to be corrected.

Presiding Examiner: So does the National City Bank.

The Witness: I am not so sure about either one of those statements. Sometimes it is best to let it lie.

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1290

Mr. Kurtz: Mr. Examiner, it is a little unusual, but instead of going through this and asking Mr. Kayser about it, as I wanted in this record, these particular points of it, I am wondering if we could not have it, if it is agreeable with counsel, copied into the record as though read? I am sure everyone here has read the application.

Mr. Shannon: It is all right with us, anything to expedite the proceedings.

Mr. Kurtz: That is all it is for.

Presiding Examiner: Mr. Kurtz, is it the application in G-13018 or 13019?

Mr. Kurtz: 13019 I am talking about.

Mr. Shannon: El Paso's application.

Presiding Examiner: What is the necessity of copying anything from the record——

Mr. Kurtz: There are various statements made by the company and Mr. Kayser here——

Presiding Examiner: There are allegations there, and you merely want to make them evidence?

1300

Mr. Kurtz: And I want to make them evidence.

Presiding Examiner: Is it sworn to, the application originally, and if so, by whom?

The Witness: By me.

Mr. Kurtz: Mr. Paul Kayser. I can go through and ask him to read these off, and ask him if he did not make the statements, and if they are not true.

Presiding Examiner: Does he now, as a witness, under oath, state as a witness that those statements in the appli-

(1250)

cation are true to the best of his knowledge, information and belief. That makes it testimony in this case.

Mr. Kurtz: That is right, that is what I am doing. I just merely wanted to mention this to you.

Presiding Examiner: What I was trying——

Mr. Kurtz: I was not going to offer all of the application, Your Honor.

Presiding Examiner: You are not offering it all. Well, suit yourself about that. Let him identify it.

Do you want to read it into the record, and then ask him if those statements are true? How do you want to handle it?

Mr. Kurtz: I just thought to save time, if there is no objection to it, I would have it copied as though read.

Presiding Examiner: Certain parts, you mean, instead of the whole application?

Mr. Kurtz: That is right.

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Mr. Shannon: Mr. Examiner, might I suggest this: There is no question but we filed this application, and we stand behind those statements. Mr. Kayser verified it. Counsel for the staff wants to have certain portions copied into the record, rather than taking time to read it, and if he will just tell the reporter what he wants copied, it is all right with us.

Presiding Examiner: I think that is a splendid idea. Mark the copy which Mr. Shannon has just handed to Mr. Kayser, show your markings to Mr. Kayser, then hand it to the reporter and let Mr. Kayser say that the parts that you have marked are true and he adopts them as his testimony in this proceeding.

Mr. Kurtz: And I will, for the benefit of the other parties here, also state generally what is being marked.

Presiding Examiner: There might be some question of relevancy.

By Mr. Kurtz:

Q. Mr. Kayser, I hand you a copy of your application and call your attention to item 4 that appears on page 3 of the application, page 4, page 5, 6 and 7, which includes the part designated as 4. I likewise call your attention to the part designated 5, El Paso's need for the facilities to be acquired, appearing on page 7, which appears on page 8 and 9. And I also call your attention to that part of the application designated 6, the business of Pacific and its prior

applications for certificates of public convenience and—wait a minute—strike that 6, I did not mean to include that. My marking is not too clear. I call your attention to the item 9 on page 12, which is headed "Grounds of Public Convenience and Necessity", and continuing on page 13, 14, 15 and the first 11 lines on page 16. And those statements that I have now called to your attention are true and correct, are they not? A. I would like to examine those carefully. I want to read them with the utmost care if I am going to testify to them with that particularity on the stand. Now we have to sign a lot of things that we know have been prepared under our direction, and we know in reason that they are true. But I want to examine exactly these statements before I know at this time, because this was signed some time back, affirm that every one of those statements are correct.

Presiding Examiner: Mr. Kayser has made an entirely reasonable request.

Mr. Kurtz: That is correct, I just thought maybe——

Presiding Examiner: And he can answer that question some time after the morning recess.

The Witness: That is fine.

Presiding Examiner: During which he will be given time

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to read the pages in question and determine whether he can make them as testimony in this case.

By Mr. Kurtz:

Q. Now, Mr. Kayser, for your information I am reading from the application of Pacific Northwest Pipeline Corporation filed in Docket No. G-13018, the instant application, before this Commission. And therein, under the grounds claimed for public convenience and necessity, it is stated that the acquisition would permit the consumers of natural gas of both El Paso and Pacific to be served by a single integrated company under the jurisdiction of this Commission which, exercising its authority under the Natural Gas Act, will regulate such a consolidated company in the overall public interest with due consideration to the efficient utilization of natural resources and their economic supply to consumers, therefore according the public the following advantages. Now those statements made relating to being served by a single integrated company are true today, are they not? Isn't that your position? A. Yes, that is our position.

1254

Q. In all the gas reserves found anywhere on those systems from Pacific and El Paso, or reasonably accessible thereto, will become available to all customers of both systems; that is correct, is it not? A. That is correct, that is the theory we are proceeding on.

Q. And the sources of gas will be available at each end of the integrated pipeline and along its routes, thus permitting gas to be readily delivered for peak demand, and employ the invested capital and existing facilities to its fullest extent. That is true, is it not? A. That is what we are trying to do.

Q. And the marketing by El Paso of large quantities of residue gas has created certain deliverability problems for El Paso which can be solved by the addition of large volumes of dry gas into its system, is that not correct? A. That is correct.

Q. What? A. That is correct.

Q. And the access to and the acquisition of such dry gas is required to meet the seasonal and peak demands on the El Paso system? A. That is right.

Q. Is that correct? A. That is correct.

1255

Q. And to balance the use of this residue gas, El Paso requires the access to the proven and potential reserves of dry gas in Canada and the Rocky Mountain area which may be obtained by the acquisition of Pacific's facilities. You so contend, do you not? A. That is right.

Q. And you likewise contend, do you not, that the demands of the California and other Southwest markets can be most economically and efficiently met through the integration of the facilities and reserves of El Paso and Pacific? A. That is right.

Q. And the growing markets in California and other points on the El Paso system are making extensive demands upon the company for additional gas? A. That is correct.

Q. And as of today you are making plans to meet these demands of your customers, both in California and other points upon your system, from the reserves in Canada? A. That is right. As a supplementary supply.

Q. And the Canadian and the Rocky Mountain gas you contend can be marketed to California and other Southwest points more economically by the acquisition of Pacific's facilities and by other means, is that not your contention? A. That is our position, that is what we think is correct.

1256

Q. And such marketing of gas would eliminate the duplication of facilities? A. Yes.

Q. And this acquisition of the dry gas would extend the life of reserves now available to the Southwest customers of El Paso, would it not? A. That is right.

Q. And you contend that the acquisition by El Paso of Pacific's facilities will make possible a more flexible operation of the two systems to the advantages of all customers? A. That is correct. That is our position.

Q. In other words, the two systems you contend are interconnected and supplement one another? A. That is right, that is what we think.

Q. And the gas reserves of west and south Texas, the San Juan Basin as well as the vital, much needed reserves of Canada and the Rocky Mountain region, will become available and can be shifted to meet the varying requirements of both the Southwest and Northwest market? A. That is correct.

Q. And the peak demands will be assured an adequate gas supply, and the growth potential of the Southwest market area can be supported by the vast new reserves of virgin character in Canada and the Rocky Mountain region? A. That is right.

1264

By Mr. Kuntz:

Q. Mr. Kayser, at the time you built the pipeline to the San Juan Basin, going back a few years, around 1950, I believe, or somewhere in there, it was the intention of the El Paso Company at that time to operate that particular line in conjunction with the rest of its pipeline system, particularly your takes from the Permian Basin, and you might describe it as more of a storage area. It was used to meet your fluctuating supply at your supply end from

the Permian Basin. That was the original intent of the San Juan line, was it not? A. That is right. That was the way it was certificated originally.

Q. That is right. A. And limited. The total quantity would be taken out and we were to have the right peak covering.

Q. And now that same policy or manner of operation exists today, does it not? A. Yes, sir, that is right. We try to maintain in that line an excess capacity for two purposes. Well, principally for one purpose. And that is to be able to use the dry gas potential to help cover the swings, as we come to call it, of the supply of residue gas in the Permian Basin, and we try to maintain in the lines leading from the point of Gallup on the map down to Topock a sufficient amount of extra capacity

1265

to help in that situation.

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Q. Now, in the takes of gas at Sumas from Westcoast, that has been in operation about a year, hasn't it? A. I think that is about right. It is about right.

Q. About a year. Is it the intent of your company to take that as close as you can to 100 per cent load factor and to take all available gas that you can from the Permian Basin

1266

and to use the balance of your dry gas fields to take care of the so-called swings? A. We do that as much as we can. Now, I wouldn't want to commit us to taking 100 per cent from Canada. It is high priced gas.

Q. I don't mean that. I am just talking about your own thinking at the time. A. As to periods in which we would need it, we would expect to do just that.

Q. Well, what I am getting at is that the gas that you take from Canada and also in your future planning even at Kingsgate—I am going over to that—you anticipate there

that you will take that at a steady rate, do you not? A. Yes, we do.

Q. But while you take it at a steady rate or in your own thinking of your operations, it forms a part of this dry gas that you need primarily to take care of this by residue gas. A. Yes. It has that stability and long life. It helps in respect to the residue gas situation. And obviously you can provide for excess capacity in those lines to cover peaks.

Q. And this Commission itself has heretofore found for the purposes of making various cost allocations as well as for other purposes that the facilities of El Paso constitute an integrated system, and I have particular reference to the

statement found in the Commission's Opinion 278, issued November 26, 1954. A. Yes, I remember. I remember that statement and the connection in which it was made. Thank you.

Q. Now, you testified on February 12, 1958, before the hearings of the Royal Commission on Energy in Canada, did you not? A. Yes, sir.

Q. And at that time, amongst other things, you were discussing Pacific Northwest's contract for an additional 150 million cubic feet of gas per day to be delivered to Pacific Northwest at the international boundary at Kingsgate opposite the State of Idaho. A. Yes, sir.

Q. And you also testified that the purposes for that sale were to see—it was for Pacific Northwest to sell and deliver this gas to the El Paso Natural Gas Company to supply additional demands of El Paso's system market, including the markets in California. A. That is right.

Q. And that is correct today. A. That is correct. The physical delivery of the gas, as I explained probably in cross-examination, was not to be technically delivered. That is correct.

Q. But without the California market you wouldn't be

1268

there. A. That is right, and I don't think they would have wanted me.

Q. And you also testified in addition you had a contract with the Westcoast Transmission for 250 million cubic feet of gas per day to be obtained from the Peace River area of British Columbia. A. Yes, sir.

Q. And without the California market you wouldn't be interested in that volume either, would you? A. Part of it but not all of it.

Q. Not all of it. A. That is right. That 250—I believe 100 million under the present plan is in effect assignable to the California market. Otherwise the balance of it is absorbed into the market without regard to California.

1269

Q. Do you mean to say that considering your present sources of supply that you cannot meet for a reasonable length of time your market demands? A. Well, let me see if you and I are talking about the same thing. Initially when we first helped Pacific Northwest make the contract and set up the market for the 300 million that they were to get from Canada, we contracted to take and deliver to the California market starting out from Mountain Home, and we knew it as our Mountain Home project, 250 million, but that broke down, as I testified, and it wound up, however, by El Paso agreeing firmly to take fifty and Pacific Northwest agreeing firmly to deliver fifty, but with the right in Pacific Northwest to put El Paso at its option another fifty, so that El Paso's obligation was for 100 million and that was taken for the California market and that importation of the 300 million would not have been feasible and probably would not have been certificated by this Commission except for the take of that 100 million by El Paso. Now, that left 200 million to be absorbed by Pacific Northwest, and that

situation has not changed except I believe that we do—I would say that you are correct in this, that at least 100 million of that gas can be taken in by reason of the demands that we are talking about because the reason for that, Mr. Kurtz, is that additional quantities

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of gas have been found and attached to Pacific Northwest out of the Big Piney, and other areas along their line. Your statement is substantially correct when you analyze it out.

Q. I am just not quite sure, Mr. Kayser, if we still have a meeting of the minds on this. Going back just a moment to what you mentioned, out of the 300 at Sumas from West Coast, while Pacific has 200 million, it permitted a backing off of certain other takes from other sources. A. Not to us. Not to El Paso.

Q. Not to El Paso, but they took it into the system. What you did on the 100 million was to turn that over at Sumas to Pacific and you took delivery. A. That is right.

Q. Actual delivery out of San Juan Basin? A. That is right.

Q. Now, my question to you, as I put it, was considering your present certified system, leaving out Provo application and your others, your present certified system, if it was not for the California market, you would not be in a position, would you, to import additional gas from Canada? A. No. That is right. 160 million——

Q. Am I right? A. Yes. That is right. You are right. The 300 million is all the obligation outside of additional markets to

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California. That is all the gas that Pacific Northwest can absorb.

Presiding Examiner: Well, how is that 100 million to be transported, by the proposed line ending at the Nevada-

California line or the one—is that under construction at the moment?

The Witness: No. That is the application for which we have filed.

Presiding Examiner: Well, what means of transportation do you have at the present time for Canadian gas to the California market of El Paso? That is what—my recollection is a little bit hazy.

The Witness: Looking at the map, Exhibit No. 1, the entry of Canadian gas at present is through the connection with the West Coast Transmission's line at Sumas. That contract calls for 300 million at that point. Now, 100 million of that by the original contract that we made with Pacific Northwest at the time the application for import was granted, was to be sold to El Paso by Pacific Northwest at Sumas, and then exchanged with Pacific Northwest for a like quantity at San Juan with a payment of a compensating factor.

Presiding Examiner: I understand now because I did not know of any transmission line.

The Witness: That is right, other than the system as it is connected up.

Presiding Examiner: I understand that.

The Witness: Yes. That is right.

Presiding Examiner: But it was not a matter of transmission. It was a matter of exchange.

The Witness: That is right. That is correct.

Presiding Examiner: Thank you. My memory had failed me in that regard. I wanted to refresh it.

By Mr. Kurtz:

Q. And the Pacific system, its location, lends itself, does it not, to the importation of gas from Canada? A. Yes, sir. Very admirably so.

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Q. And that is why you want to and did purchase Pacific, is it not? A. That is one of the main reasons we purchased it.

Q. And at the present time, by reason of that location and of the Pacific's system, you are in a position to take that gas very readily, are you not? A. Yes. That is exactly correct. As I testified in both the Borden Commission and to the Conservation Commission of Alberta, we were particularly well suited to take it in accordance with their wishes because we could take a small amount or we could take a large amount. Having a connection made it possible to do that, plus the fact that as to Kingsgate, Spokane is only 123 miles away. So you were relieved of the necessity of making a very great capital

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investment to take additional quantities of Canadian gas.

Q. Now, I don't know whether it is in this record or not, but the production of your residue gas in the Permian Basin is dependent upon the allowables set by the Texas Commission, is it not? A. Yes, sir. While Texas does not cover all of the Permian Basin, nevertheless, the orders of the Commission in Texas set the pace largely for the adjoining production in Lea County, New Mexico.

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Q. Mr. Kayser, since you first began service to the California company, Southern California Company, then to P G & E, have you met their demands for natural gas that they required from out of the state? A. Yes, I think it is fair to say that we have. I think it is fair to say we have.

Q. In spite of the fact that there are increases year by year, and you have built the facilities to meet those increases. A. Yes. Now, I would like to make the exception that in the recent past when the companies, the Southern

companies, contracted with Transwestern for the additional quantities from them, that we did not have available that 300 million to sell to them, and to that extent, we did not meet their demands.

Q. Well, let me ask you this: At any time that you made certificate applications to this Commission for large increased volume, you had to go out and get the gas; didn't you? A. Yes, that is correct.

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Q. But have you ever refused to build facilities to meet their requests? A. We certainly have not, and, on the other hand, of course, we have always tried to do as hard a selling job as we could to convince them that we could supply the quantities they wanted.

Q. Did I understand you correctly to say that you were unaware of the negotiations that were going on between Pacific Lighting—I believe it is Pacific Lighting, or whatever the name of the company is—— A. That is the top company that owns the stock, the holding company.

Q. The holding company of the Southern California Gas Company—and Transwestern? A. Well, I knew that some discussions were going on, but I did not know of the seriousness of the discussions.

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Q. But they didn't—while they might have mentioned it, you didn't recognize the seriousness of it? A. That is correct.

Q. And if you had, would you have made—— A. I would have done a lot more talking. I will put it that way. Whether I would have done any good or not, whether I would have sold any gas or not, I don't know.

Q. Let me ask you this: Today, are you in a position to

deliver an additional 300 million to the Southern California Companies? A. No.

Q. What would it take to put you in that position? A. Well, we would have to contract for approaching 300 million.

Q. You would what? A. We would have to contract for an additional approximately 300 million.

Q. And where would the gas come from? What area? A. Well. to put that together, well, it would come from the general areas where we are operating.

Q. You have made studies, have you not, then, for the additional volumes going to the California market over and above

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those that you have applied for here to this Commission? A. Yes, we have.

Q. Mr. Kayser, any price at the Canadian border that is to be laid down will depend upon what that gas can be sold for in the California markets, either to the San Francisco Bay area or the Los Angeles area. Is that not correct? A. Yes. I think that those markets would probably be the determinative price at this time.

Q. Do you know anything else that might—— A. Yes. I was just going to say.

Q. What? A. I think it is not impossible, in the event of scarcity of Btus, for the interior markets to be able to pay the higher price than the coast markets.

Q. When you say "interior", what do you have in mind? A. Back from the West Coast, like Arizona, Nevada, Idaho, and that portion of the border states that is back from water transportation. And, also, that is less influenced by importation. All of those things affect the price of fuel oil.

Q. Well, the foreseeable markets in the areas that you just mentioned wouldn't justify large volumes of importation of gas from Canada; would they? A. Well, you have to look way down the road.

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Q. At the time that you made this arrangement and you mentioned Mountain Home, Idaho, you were proposing a line from that point to the Nevada-California border for sale to P. G. & E. Now, the hearing came on before this Commission and P. G. & E. refused to take gas at that point, but took the additional volumes at Topock. Is that in general what happened?

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A. Yes. It is a little more complicated than that.

Q. Well, I am not familiar with that application. A. Well, here is what we were trying to do, and we thought we had it done, and then it broke in two. It wasn't tied tight enough.

That 250 million was to be divided between Pacific Gas & Electric and the Southern Companies. The pipeline connection was to be made at a point not far from Carson City-Reno area on the California-Nevada border. Pacific Gas & Electric was to build the pipeline up there which was only, I think, about less than 150 miles from the Bay area, and an exchange arrangement was to be made between the Pacific Gas & Electric Company and the Southern Companies so that they would have backed off to them for a proper sum their so-called shares, that is, one-half of that gas that would be brought in through that new line through the Carson City gateway.

Now, Pacific Gas & Electric would never agree on taking the deliveries at that point, nor did they ever agree on a cost of delivering the quantity that would be required to be delivered to the Southern California people. Those were two items that were never tied completely tight.

Now, they did offer simply to take that quantity of gas and they didn't even like to call it Canadian gas. We will take it at Topock. You bring it over there and we will take

it. And that, of course, we couldn't do under the arrangement

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that we had.

Q. Were you informed at that time by P. G. & E. of their reasons for not taking the gas near Carson City? A. Well, the biggest reason was they just didn't want to do it.

Q. Well, I appreciate that, but I was wondering if they had informed you of their reasons. A. Well, they said that they did not regard the Mountain Home line as a proper and economic piece of construction. We offered to take the line off at Pendleton and bring it straight down to Klamath Falls, but they likewise objected to that. I am not going to say that they said to me that they wanted to bring in their own gas from Canada. But my own judgment at the time was that those plans which were nebulous but nevertheless in their thinking were the real cause.

Now, I am not saying that—I am just saying that was my judgment. I am not quoting them. I am not impugning any motives to them that they did not have. I am just saying that is the way it looked to me from where I was sitting.

Q. Now, as I understand it, prior to your acquisition of the stock of Pacific, you were in competition—there was competition between Pacific Northwest and El Paso for certain markets in the State of California. A. That is right. We were both trying to sell

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specifically Pacific Gas & Electric Company quantities of gas.

Q. Well, at one time you even had plans, did you not, for taking gas from the Louisiana Gulf across Texas to California. A. Yes.

Q. And you bid upon gas reserves commonly called the Cateo gas, on which Tennessee outbid you. A. That is correct.

Q. And that was about the same time that—when was

that? Let us put it that way. I am a little bit lost. A. That was in the spring. That was in the spring of 1956. I am quite sure that is correct because in August of 1956 we talked to Southern California Edison Company. Now, at the time that we were working with the Cateo gas, we were planning and talking with the Southern California people to bring that supply of gas in to satisfy the rather insistent demands for larger quantities of firm gas that the Southern California Edison were making upon them.

Q. That is right. In other words, the market was—— A. Southern California Edison.

Q. Southern California Edison Company, which is an electric company. A. That is right. But it was likewise, now, in connection with the Southern California Gas Companies to satisfy part of their market as well.

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By Mr. Kurtz:

Q. Mr. Kayser, during the noon recess have you had occasion to read the parts of your application in the instant docket of El Paso that I handed to you this morning? A. Yes, sir, I have.

Q. And they represent your views as of today? A. Yes, sir, they are correct, and I am willing to state that on the stand just exactly as it is stated in the application and sworn to by me.

Mr. Kurtz: In order to save time, Mr. Examiner, at this time I would ask that there be copied into the record as though read——

Presiding Examiner: Let's have this understanding about it:

You have marked clearly and understandably by the witness, Mr. Kayser, the parts that you want in the record as his testimony. And you do adopt it as your testimony?

The Witness: I do just that. I read it from the marks

exactly.

Presiding Examiner: So the reporter will please receive from Mr. Kurtz the original application in Docket G-13019 —is it not?

Mr. Kurtz: Yes.

Presiding Examiner: —and the parts that are marked, as I have just described, will be copied in at this point as the testimony of Mr. Kayser.

The Witness: Correct.

Four: Business of El Paso and Its Prior Applications for Certificates of Public Convenience and Necessity:

El Paso is a natural gas company within the meaning of the Natural Gas Act. Its principal business is the ownership and operation of natural gas pipeline transmission facilities consisting of approximately 6700 miles of main and lateral pipelines. It is engaged in the production, acquisition by purchase, processing, transportation and marketing of natural gas.

El Paso delivers and sells at wholesale natural gas to customers in West Texas, Southern and Northwestern New Mexico, Arizona and to distribution companies at the Arizona-California boundary which companies transport the gas so sold and delivered through their distribution systems to consumers in California and Nevada.

El Paso was incorporated on November 28, 1928. Its

original pipeline system, which extended from Lea County, New Mexico to El Paso, Texas, was completed in 1929, and was subsequently extended to Phoenix and other areas in Arizona. Its then existing pipeline system was first certificated by this Commission in Docket No. G-288. Subsequently thereto its line was extended to Blythe, California, where connections were made for delivery of gas to California distribution companies.

Thereafter, as shown by the various El Paso Dockets hereinafter listed, in response to demands upon it for deliveries of additional quantities of natural gas to its customers, El Paso was authorized in said Dockets to enlarge and extend its facilities and operations and to increase the volumes of gas to be transported.

The principal applications for certificates of public convenience and necessity heretofore filed by El Paso are the following:

Docket No. (a) G-288

Covering the gas pipeline system existing in 1938.

Docket No. (b) G-655

For the transportation of 305,000 Mcf of natural gas per day from the Permian Basin in West Texas and Southeast New Mexico, and from the Panhandle Field in Texas, to Blythe, California, and delivery to the Southern

Counties Gas Company of California.

Docket No. (c) G-931

For the transportation and sale of an additional 20,000 Mcf of natural gas per day to various customers of El Paso.

Docket No. (d) G-1019, G-1051, G-1177

For the transportation of an additional 250,000 Mcf of natural gas per day from the Permian Basin in West Texas and Southeast New Mexico, for delivery to the Pacific Gas and Electric Company at the Arizona-California boundary near Topock, Arizona.

For the transportation of an additional 180,000 Mcf of natural gas per day from the Permian Basin in West Texas and Southeast New Mexico, and the delivery of 100,000 Mcf thereof jointly to the South-

ern California Gas Company and the Southern Counties Gas Company of California, at Blythe, California, and the delivery of 80,000 Mcf thereof to other customers of El Paso at various points in Arizona, New Mexico and Texas.

For the transportation of 167,000 Mcf of natural gas per day from the San Juan Basin in Northwest New Mexico and Southwest Colorado, whereof 150,000 Mcf per day were for delivery

to the Pacific Gas and Electric Company at the Arizona-California boundary near Topock, Arizona, and 17,000 mcf per day were for delivery to the Town of Gallup, New Mexico, and various other cities and towns in Northern Arizona and New Mexico.

Docket No. (e) G-1629

For the transportation of an additional 100,000 Mcf of natural gas per day from the Permian Basin in West Texas and Southeast New Mexico, and delivery to El Paso's customers located in Arizona, New Mexico and Texas.

Docket No. (f) G-1630

For the transportation of an additional 120,000 Mcf of natural gas per day from the San Juan Basin in Northwest New Mexico and Southwest Colorado, whereof 100,000 Mcf per day were for delivery to the Pacific Gas and Electric Company and/or the Southern California Gas Company and the Southern Counties Gas Company of California at a point or points on the Arizona-California boundary; and up to a maximum of 20,000 Mcf per day were for delivery to the Nevada Natural Gas Pipeline Co. at a point on the Arizona-California boundary, near Topock, Arizona. Additionally, applicant was granted

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authority to deliver in excess of 34,000,000,000 cubic feet of natural gas per year through facilities previously certificated by the Commission in Docket No. G-1177.

Docket No. (g) G-1631

For the transportation of an additional 200,000 Mcf of natural gas per day from the Permian Basin in West Texas and Southeast New Mexico for delivery to the Southern California Gas Company, Southern Counties Gas Company of California, and Pacific Gas and Electric Company, at points on the Arizona-California boundary.

Docket No. (h) G-1998

Covering the acquisition of certain facilities from the West Texas Gas Company to be operated for the transportation of natural gas in Randall, Deaf Smith, Castro, Parmer, Bailey and Lamb Counties, Texas.

Docket No. (i) G-2106

The Federal Power Commission issued a Certificate of Public Convenience and Necessity to this applicant authorizing it to construct and place in operation facilities to transport from the Permian Basin in Southeast New Mexico and West Texas an additional 300,000,000 cubic feet of natural gas per day, and from the San Juan Basin in Northwestern New Mexico an

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additional 100,000,000 cubic feet of gas per day, said gas to be sold to the Southern California Gas Company, Southern Counties Gas Company of California and Pacific Gas and Electric Company in the amount

of 300,000,000 cubic feet per day and to applicant's existing coustomers in West Texas, New Mexico and Arizona volumes of up to 100,000,000 cubic feet per day.

Docket No. (j) G-8940

The Federal Power Commission issued a Certificate of Public Convenience and Necessity to El Paso authorizing it to construct and operate facilities for the purpose of transporting an additional 450,000,000 cubic feet of natural gas per day to the Southern California Gas Company, Southern Counties Gas Company of California, and Pacific Gas and Electric Company, and El Paso's existing customers in West Texas, New Mexico and Arizona. Deliveries were authorized in the amount of 175,000,000 cubic feet per day to the Southern California Gas Company and Southern Counties Gas Company of California; 175,000,000 cubic feet per day to Pacific Gas and Electric

Company; and 100,000,000 cubic feet per day to El Paso's existing customers in West Texas, New Mexico and Arizona. In addition, El Paso was authorized to make various exchanges of natural gas with Pacific Northwest Pipeline Corporation in the San Juan Field of Northwestern New Mexico and at the United States-Canadian boundary at or near Sumas, Washington, all as more completely described in the application filed by El Paso in Docket No. G-8940.

Docket No. (k) G-10499

The Federal Power Commission issued a Certificate of Public Convenience and Necessity to El Paso

authorizing it to construct and operate facilities for the purpose of transporting an additional 150,000,000 cubic feet of natural gas per day to the Southern California Gas Company, Southern Counties Gas Company of California and Pacific Gas and Electric Company. Deliveries were authorized in the amount of 75,000,000 cubic feet per day to the Southern California Gas Company and Southern Counties Gas Company of California and 75,000,000 cubic feet per day to the Pacific Gas and Electric Company.

Docket No. (l) G-11797

An application is pending and hearings

thereon are now in progress before the Federal Power Commission for Certificate in this Docket. El Paso seeks authority to construct and operate facilities for the delivery of 150,000,000 cubic feet of natural gas per day to its California customers, and for the delivery of 35,000,000 cubic feet of natural gas per day to customers in Arizona, principally in Yuma, Arizona.

Docket No. (m) G-12580

In this case, El Paso seeks authority to deliver 100,000,000 cubic feet of natural gas per day to the Southern California Edison Company through the facilities of the Southern California Gas Company and Southern Counties Gas Company of California. Hearings are also being held on this Docket.

Reference is hereby made by El Paso to the applications for Certificates of Public Convenience and Necessity that were filed in the Dockets referred to above for an additional description of the existing business, operations and properties of El Paso.

Five: El Paso's Need for the Facilities to be Acquired:

El Paso is now authorized to transport approximately 2,488,000,000 cubic feet of natural gas per day through its main line transmission facilities to its customers in West

Texas, New Mexico, Arizona, Nevada and California. Two applications for certificates, Docket Nos. G-11797 and G-12580, are now pending seeking further expansions of its system for the delivery and sale of an additional 285,000,000 cubic feet of natural gas per day. In response to its customers' demands for still additional gas, El Paso will in the near future request authority to transport and deliver an additional 500,000,000 cubic feet of natural gas per day.

The expansion of El Paso's transmission facilities and the increased quantities of gas now marketed by it and which it proposes to market is attributable to the rapid population and industrial growth of the region served by it.

El Paso has pioneered in the marketing of residue gas and sells a greater quantity thereof than any other pipeline company. Of the approximately 2.5 billion cubic feet of natural gas per day which it presently transports, approximately 1.5 billion is residue gas.

Residue gas is produced in connection with the production of oil. The quantities thereof available are dependent upon the allowable production of oil. This results in limitations upon the total quantities of residue gas which may be produced and in variations in the rates of daily production thereof.

Prior to the development by El Paso of a method of utilizing such gas for public consumption, such gas was considered a waste product and was flared, resulting in an enormous waste

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of an important natural resource.

The marketing by El Paso of vast quantities of such residue gas presents, however, serious problems. Because residue gas is not produced in response to its customers' demands, but rather in response to the daily allowable production of oil, deficiencies in quantities available and irregularities in the daily supply thereof require El Paso to supplement the supply of residue gas with large quantities of dry gas.

It accordingly explored for and developed dry gas reserves principally in the San Juan Basin. In addition, El Paso is now and for the past several years has been engaged in an extensive exploration and development program not only in the Permian and San Juan Basins but also in the Rocky Mountain area and in Western Canada.

These efforts are directed to the increasing of El Paso's dry gas reserves and are necessary to meet the peak demands on El Paso's system so as to enable it to overcome the wide fluctuations and periodic deficiencies in the supply of residue gas.

Additional dry gas will permit El Paso to marked increased quantities of residue gas.

As a further result of the marketing by El Paso of substantial quantities of residue gas, El Paso has one of the shortest debt amortization schedules in the industry. Most of the bond issues have had 15 to 18 year maturities. This

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onerous amortization schedule has been due to the relatively short assured life of residue gas reserves and the large quantities of this gas marketed by El Paso. To lengthen its amortization schedule, El Paso requires additional dry gas reserves and for this reason urgently needs access to the potentially large reserves of such gas in the Rocky Mountain area and in Western Canada.

In an effort to meet the rapidly increasing gas demands of El Paso's customers in California, particularly where local smog control efforts have accelerated the demands, El Paso has sought a means of access to the vast proven and potential dry gas reserves of the Rocky Mountain States and Western Canada. Pacific's pipeline system, coursing as it does the Rocky Mountain region and possessing connections to the fields of Western Canada, provides the only available means of such access, short of a duplicating line.

El Paso recently acquired practically all—99.8 per cent—of the common stock of Pacific. Now, to give and assure El Paso's customers the benefits of these reserves, transported in the most efficient and economical manner, El Paso proposes to acquire and operate the Pacific system.

Included with and made a part of this application as Exhibit F are geographic maps of suitable scale and detail showing and appropriately differentiating between all of the facilities of Pacific which El Paso will acquire and operate if

this application is granted.

All the exhibits, which are set forth in the Table of Contents Listing Exhibits at the end of this application, are made a part of this application and are filed in conformity with the Commission's Regulations under the Natural Gas Act, and are for the purpose of showing fully the effect of the acquisition and operation of Pacific's facilities by El Paso. They furthermore demonstrate that the present and future public convenience and necessity will be served by the acquisition and operation of Pacific's facilities by El Paso, that such ownership and operation is economically feasible and that El Paso is able and willing to perform properly the acts required to consummate the acquisition and operation of such facilities.

Nine: Grounds of Public Convenience and Necessity:

El Paso represents that the acquisition by it of the facilities and assets of Pacific and the operation thereof by El Paso, as requested in this application, are and will be required by present and future public convenience and necessity. The acquisition would permit the consumers of natural gas of both El Paso and Pacific to be served by a single integrated company under the jurisdiction of this Commission which, exercising its authority under the Natural Gas Act, will regulate such a consolidated company in the overall public interest with due consideration to the efficient utilization of natural

resources and their economical supply to customers, thereby affording the public the following express advantages:

(a) Every customer of each separate company has an interest in seeing that his supplier is backed by the most comprehensive gas reserves possible in order that he may be assured of long continued economical gas service. All gas reserves found anywhere on both systems or reasonably accessible thereto will become available to all customers of both systems. The life index of such reserves will be materially increased, thus assuring all customers sufficient gas sources to meet their present and future demands and providing for more efficient utilization of natural resources.

Sources of gas will be available at each end of an integrated pipeline and along its route, thus permitting gas to be readily delivered for peak demands and employing the invested capital in existing facilities to its fullest extent. Large or small quantities may be more economically transported with resulting lower cost to the consumer.

(b) Although the marketing by El Paso of large quantities of residue gas has served a valuable economic function

in the prevention of waste, it has created deliverability problems for El Paso which can only be solved by the addition of large volumes of dry gas to the reserves available to El Paso. In this way, El Paso may make more adequate provision now and in the future against the deficiencies and

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irregularities in the supply of residue gas. The availability of residue gas is subject to oil production schedules rather than to the need of the gas consumer. It is more readily available in summer and in the early days of the month. Such availability bears no relationship to the seasonal or peak demand of the gas user.

Access to and acquisition of such dry gas is required to meet the seasonal and peak demands on the El Paso system. Hence, to balance the use of residue gas, El Paso requires the access to the proven and potential reserves of dry gas in Canada and the Rocky Mountain area which may be obtained by the acquisition of Pacific's facilities. It is in the public interest that residue gas be economically utilized.

(c) The demands of the California and other southwestern markets can be most economically and efficiently met through the integration of the facilities and reserves of El Paso and Pacific.

The growing markets in California and at other points on the El Paso system are making extensive demands upon the company for additional gas. There are now pending before this Commission applications by El Paso to deliver an additional 285,000,000 cubic feet of gas per day.

To meet the further demands of its customers, El Paso is now planning a further delivery of an additional 500,000,000 cubic feet of gas per day. This latter gas must come largely

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from the reserves in Canada and the Rocky Mountain States.

Canadian and Rocky Mountain gas can be marketed to California and other southwestern points more economically by the acquisition of Pacific's facilities than by any other means. Duplication of facilities can be avoided. The life index of reserves now available to the southwestern customers of El Paso will be increased. With the availability of gas at the northern and southern extremities of the combined systems, as well as along its route, small quantities of gas may be easily and economically shifted, and maximum advantages may be taken of capital expenditures. The unit cost of gas transportation must inevitably be reduced by such a full utilization of existing facilities.

The proposed acquisition by El Paso of Pacific's facilities will make possible a more flexible operation of the two systems to the advantage of all consumers. The two systems are interconnected and supplement one another. The gas reserves of West and South Texas, the San Juan Basin, as well as the vital, much needed reserves of Canada and the Rocky Mountains will become available and can be shifted to meet the varying requirements of both the Southwest and Northwest markets.

Peak demands will be assured an adequate gas supply and the growth potential of this southwestern market area will be supported by the vast new reserves of a virgin character in

Canada and the Rocky Mountain region.

(d) Maximum and efficient utilization of the existing El Paso system in the public interest will be the consequence of the acquisition. The acquisition will provide access to a source of reserves which can service markets now supplied by El Paso, and assure continued utilization of residue gas.

Moreover, the acquisition will assist in the resolution of the financing problem resulting from utilization of residue gas. The life index of reserves of residue gas is relatively

low. This has caused a range of only 15 to 18 years in the maturities of most of El Paso's bond issues. El Paso therefore bears a heavier burden than any other gas transmission company in meeting its amortization schedules.

El Paso has been steadily endeavoring to increase the percentage of dry gas marketed by it. By increasing the ratio of dry gas to residue gas, the life index of El Paso's total gas reserves will be extended. Thereafter the range of maturities of its bonds can be accordingly extended. Such a result, however, can be accomplished only if El Paso possesses the requisite access to sources of dry gas which the Pacific facilities provide.

Finally, El Paso, in order to provide for the future requirements of its customers, has acquired in its own right proven and potential gas acreage in Canada, access to which is now available only through the facilities of Pacific.

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Ownership of these facilities by El Paso provides the most economical means of utilizing these gas sources.

(e) Maximum and efficient utilization of the Pacific system in the public interest will be the consequence of the acquisition. The mounting demand for gas in market areas connected to El Paso's pipeline system provides the incentive for and requires the early development of the gas potential in Canada and the Rocky Mountain area. This demand justifies the immediate large expenditures necessary for such a program. The markets presently available to Pacific alone do not justify such an extensive gas acquisition program.

Accordingly, Pacific's customers will have developed for them at an early date large gas reserves which will be available for their future needs and the inevitable future growth of the Pacific market.

The logic of this interdependence can be singularly illus-

trated by the El Paso agreement to take 100,000,000 cubic feet of gas per day from Canada which made feasible the delivery of a quantity of Canadian gas to the Pacific market which would not alone have justified its importation. El Paso proposed to employ an additional 300,000,000 cubic feet of Canadian gas per day in the near future. This will make it possible for other or smaller quantities of gas to be moved from Canada for the use of Pacific's customers whose collective demand might not justify such deliveries.

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With the increasing use by El Paso of Canadian gas, the unit cost of such gas to Pacific customers will inevitably be reduced.

Moreover, this same increasing El Paso demand for gas will bring about a maximum utilization of the entire Pacific pipeline system. Its overall load factor will be increased thereby reducing the unit cost of all gas to Pacific's customers.

El Paso's substantial gas reserves in Canada will become available to all customers of Pacific as well as to the customers of El Paso. Furthermore, all of El Paso's domestic reserves will likewise be available to all of Pacific's customers. These latter reserves are of particular importance to the Pacific Northwest market since this Commission has already determined that it is in the public interest that this region be not solely dependent upon a foreign gas supply.

By Mr. Kurtz:

Q. Mr. Kayser, along that line of an integrated system, when you took over the active management of Pacific, at that time operational-wise you were integrating the two companies, Pacific and El Paso, were you not? A. Yes, sir.

Q. Now, going back into a period of time in 1954, at the time of the original contract between Pacific, Westcoast and also with your company, at that time you had your

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engineering staff prepare various ways, relating to the construction of a pipeline, to transport Canadian gas to California? A. Yes, known as the Mountain Home Project.

Q. And at that time you thought the result of the combination of the Pacific System for the transportation of Canadian gas to California was the most economical way to transport such gas? A. Yes.

Q. And do you still think so? A. That is right, the two together. But, now, let's not get a little confusion. I always thought—thought then and think now—that there was a great deal of difference in having the two separate corporations, and that to me, obviously, the maximum results could be obtained by merger.

As indicated in the propositions that we had at first, we were insisting upon merging the properties, and we only changed over because we could not do it otherwise.

Now, I do want to make it clear that we would not know how to operate the properties as separate entities if the Commission in this proceeding should deny the merger, because we are proposing to operate them as an entity.

Now, if the Commission should say that it is not the way to do it, the problem involved in trying to keep them separate after a finding of that sort would be so great that

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I do not know how to go about it. We might have been able to do it if we had never been attacked by the Attorney General, or had never filed an application for a merger. Once having filed it, and if the Commission finds that that is not in the public interest, then the problem of keeping the two separate in a number of ways would become, to me, insurmountable.

Q. Now, in that regard, what you have in mind is there is a suit in Salt Lake City against your company; isn't that correct? A. That is part of it.

Q. That is part of it? A. Yes, that is part.

Q. Now, at the present time you are operating El Paso and Pacific on an integrated basis——, A. That is right.

Q. —are you not? A. Well, yes; as integrated as we can, under the circumstances, because we have had to hold them a measure apart, if nothing else out of deference to the fact that the Attorney General of the United States has filed the suit, and we have to be prepared, that we would be able to divest. In other words, he has indicated in the pleadings that we should not so scramble the two properties that they could not be separated.

Now, we have respected that, of course. Not out of any desire to be "nice boys", but because we think that is

what ought to be done under the circumstances.

Q. Well now, let's just take, for example, and I am forgetting that, if you could lay it aside; I do not know whether you can in your thinking—the suit of the Attorney General, forgetting it for the moment, but for instance in your Provo Line, you are constructing that now—that is a combination of El Paso and Pacific, and even Colorado Interstate working together? A. That is right. At the moment it is only contractual.

Q. That is right. There is no doubt in your mind but what that will go through, is there? A. Wait a minute. That is not for me to say. I hope that it goes through—very, very much.

Q. All right. And in your relations in the San Juan Field, your company has taken over that operation, operating the properties, has it not? A. Yes, but if the merger is denied —because we cannot, in our thinking, think except in terms of the granting or denial of the merger, and all of the future is determined by that fact, it hinges on it and starts out from that point.

Now, if it should be denied, then we would be unwilling to continue to operate the field properties.

1308

Q. Why? A. Because we think it would give us continual trouble, antitrust suits, a question before the Commission on any application that we make, allocation of cost, relationships; are they proper and are they improper?

We are not interested in owning the stock for investment, and if the Commission should say it is not in the public interest to merge, then the effect on our entire public relations would be such that it would be highly impractical to try to operate separately, and we would, in fact, make plans to dispose of the stock.

You see, we have been charged with violating the antitrust law.

Now, even forgetting this particular suit, if the Commission says it is not in the public interest to operate these as a unit, then any time that we, the larger company, have any transaction with Pacific Northwest, the smaller company, we would be under scrutiny by everyone.

It just is not practical to do it from our standpoint.

Q. Why did you enter into the agreement for the operating of Pacific's properties in the San Juan, with this and what you are now saying? A. Well, now, I can tell you exactly.

The first agreement was entered into in light of the plan that we had based upon the contracts of December 11,

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1954, in which we had bought the Canadian gas and had put in, so to speak, with Pacific, to help make them a success and to obtain the Canadian gas down through that method.

Now, as early as that time, we were negotiating in respect, as you know—the record shows it—well, not right at 1954, I do not believe—I do not remember that exactly,

but certainly the last part of '54 and '55, as the record shows—and we made that first contract as part of our original desire to aid them in financing, in getting their whole project constructed, and in delivering to us 250 million feet of Canadian gas.

Now, that is part of that. That is all part of that.

Now, when we came around later, we amended that a little but not much. Then, after we acquired the stock, we broadened that contract very substantially, and, since then, we have been going beyond anything that the contract had, on the basis that it was in the public interest not to bring about, I mean, to avoid all capital expenditure as far as we could. and Pacific was not able to make it.

Q. There have been numerous contracts entered into between El Paso and Pacific, relating to gas in the San Juan Basin; have there not? A. Well, there have——

Q. I meant, it is in the record. A. I can tell you there are three important ones.

1310

Q. All right. A. But only three important ones.

The others, they are little. There is a whole stack of them, but they are little changes that are not important.

But the three important ones:

The first one— if I remember correctly now—was one in which we agreed to furnish to Pacific Northwest 100 million cubic feet of gas a day for three years, and then 60, and then 40, over a five-year period.

And they agreed, under certain conditions, later to return that gas to us. We called that, I believe, "the exchange agreement".

Now, that was done at the time, and in the light of the contracts that we had for 250 million of Canadian gas, plus the fact that we knew from the inside properly of the Pacific Northwest picture that they needed that to help them in their financing and to avoid the immediate expenditure

of very large sums of money that they would have to obtain in additional financing to drill up their properties, to produce the deliverability that was required initially to open the pipeline.

So, we said: "We have it. It won't hurt us; for three years you can get it from us; and we will contract it to you, and then you are expected to taper off 60 million the fourth year, and 40

1311

million the last of the five years."

Now, that was an important contract to them, because it was helpful to them in their financing.

Now, the next contract was one in which we agreed with them—this was, I would not say, entirely arm's length, but it was pretty close to it. Now, that one, we just did that to help. It was no value to us. But Pacific Northwest had most of their acreage and new locations for new wells on the east side of the field, and we had the preponderance of ours on the west side.

Consequently, we had an elaborate gathering system all over the principal part of the field and very much on the west side of the field, while Pacific had its gathering system on the east side of the field.

Now, Pacific, though, had certain leases, some wells, I think, of their own; but whether they were their own or whether they were other people's wells is unimportant.

In order to get the gas out of them, you had to connect them in with the gathering system into your system.

Now, for them to go over there and build a system, over to the west side of the field—and that is a rough situation out there; the terrain is not easy—would have been very expensive.

Correspondingly, we had some wells on the east side of the field we could more economically attach to their system

1312

and then exchange the gas.

Now, we made a limited contract in that case for that exchange, one that was mutually beneficial.

I would not be willing to extend it if the two companies are to be entirely separate.

Now then, later, we expanded that in light of the negotiations and the contract for the merger.

And still later, we made a comprehensive contract in which we, ourselves, took over the operation of both gathering systems.

Now, I want to tell you this: that if the two companies are entirely separate, and you found after all the evidence there ought to be competition between them, they should not be merged, then it would be a very dangerous thing for us to continue that contract; because it is so easy for a producer to say, "Oh, you just control the entire thing. You are pushing us out on one side, while if we had true competition with Pacific Northwest, we could get in."

Now, that is the kind of thing we would be faced with in the field. We do not want to be faced with it.

1313

Q. But it does not make for economic development of an area, or the price of gas, to have two gathering systems, say, connected to one well, does it? A. No, but it is not quite that drastic.

Q. Pacific owns interest in wells and El Paso owns interest in the same wells, do they not? A. That happens.

Q. Yes. A. But, I mean, that kind of a thing generally—

Q. That is extreme, but as you say, this exchange of gas, they own one next to your gathering system, and you have one over to the other, and it's mutually to advantage to put it into the system? A. Economically, yes, but if you have

to operate the two companies separate, as independent entities, there is a lot of difference.

Q. You just would not like it, would you? A. No, and I would not do it. There is a difference between it, now, and let me tell you. If we did not own the stock, then we can always defend ourselves. Well now we are doing this for our interest and for their interest, it is a valid arm's length contract. Now owning all the stock it is just foolishness to talk about you are going to make an arm's length contract. I mean, you cannot defend it. You might make it ever so good and clean, but when it is attacked you

are behind the biggest eight-ball you ever saw.

Q. Because you just cannot defend it? A. Cannot defend it from the standpoint of saying it is an arm's length contract.

Presiding Examiner: We have seen some of them here before the Commission, that try to look pious from behind the eight-ball. The same situation.

The Witness: But you recognize they are behind the eight-ball.

Presiding Examiner: Certainly it has loomed up.

The Witness: I wanted to make that clear, and I appreciate your letting me do it.

Presiding Examiner: While I have interrupted, Mr. Kayser used the expression "Mountain Home Project".

The Witness: Yes, sir.

Presiding Examiner. In relation to something. I just want to be sure that that is well understood in this record. Now what are the limits of the Mountain Home Project? Is that the one where you deliver gas to the Nevada-California boundary?

The Witness: I can show you on the map. It stops at a little place in Idaho called Mountain Home.

Presiding Examiner: I have located that on the map and can see it. It is in the southwest corner of Idaho.

The Witness: Right. We proposed a line at that time directly down to the Reno-Carson City area and to join a line

1315

built by Pacific Gas & Electric from the Bay area up to a connection with our line at the boundary between Nevada and California.

Presiding Examiner: That has now been abandoned?

The Witness: Oh, yes, it was abandoned when we were absolutely unable——

Presiding Examiner: At the time you used it, I did not recall just what its limits were.

The Witness: That is it.

Presiding Examiner: Excuse me. Proceed.

By Mr. Kurtz:

Q. Mr. Kayser, while we are on the subject of negotiations between the two companies, so we can keep the record straight on this matter—— A. Yes, sir.

Q. —back in February of 1955 I believe that you instructed Mr. Norwood to work out, well, in other words, to make a study of the Pacific Company which involved even Mr. Norwood sending people to Houston, Texas, relating to a possible acquisition; is that not correct? A. I think that is correct. That is what I was saying awhile ago, we were negotiating and talking about a merger in the first part of '55.

Q. And the fact of the matter is there were many studies made after that for you by Mr. Norwood or his department?

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A. Well, a number. I would not say too many, but there were a number, that is right.

Q. And amongst those studies was a project to transport,

back in March of '55, a project to take all of the San Juan gas to the California market. Do you recall that? A. To take all the San Juan——

Q. All the gas out of the San Juan and move it to the California market? A. No, I do not remember that.

Q. You do not recall that. All right. A. I just do not.

Q. Well I know this is getting back into a little period of time, but—— A. I know there were discussions of that, and I think—well, there were discussions of it, but I do not remember ever ordering any study to be made in that respect, because that never seemed to me to be the correct method of approach to the matter.

Q. All right. In March of 1955 you made an offer to Pacific, to Mr. C. R. Williams, which you considered, as I said, at that time, was your final offer, and the offer was an exchange of 650,000 shares for all of Pacific's common, namely, 697,298 shares. Do you recall in substance such a conversation? A. Yes, I recall the negotiations back and forth on the basis—that is the original stock outstanding of Pacific

1317

Northwest.

Q. Then in April of '55 they drafted up a stock purchase agreement—even went so far, did you not? A. Well, I think that the files show that agreement, but I do not remember that with the clarity that I ought to. I remember the negotiations, I remember the negotiations, I remember the fact of the discussions in respect to the practically 700,000 shares of Pacific Northwest that was then outstanding.

Q. And then in April 27, 1955, at a Board meeting in New York, there was present yourself, Mr. Bradford, Mr. Cragin, Mr. Steen, Mr. Vanston and Mr. Wagner, and the meeting was called for the benefit of directors not present at the April 19, 1955 meeting, in which you reviewed at length the discussions and developments that occurred during the

last stages of the negotiations, the various alternative proposals that had been considered, and the legal obstacles and other considerations that lead to the determination by the Board of Directors of the Company at said April 19 meeting not to proceed further with such proposed acquisition in any form. Do you recall that? A. That is right, I sure do.

Q. And then in a period of time in May of 1955, May 19 to be exact, the Sumas application was filed with this application in Docket No. G-8934. Does that sound about

1318

right? A. The Sumas?

Q. Yes. A. Yes, that is about right.

Q. I am not talking about the contract, I am talking about when the application was filed here. A. That is right.

Presiding Examiner: What do you mean, the Sumas application, for a certificate here, Mr. Kurtz?

Mr. Kurtz: Yes, in Docket No. G-8934, which resulted in agreement at the end of '54.

Presiding Examiner: That is for a petition for gas at Sumas?

Mr. Kurtz: Yes.

The Witness: From Canada.

Presiding Examiner: All right. Excuse the interruption.

By Mr. Kurtz:

Q. And there was another meeting, and that went back and forth, but bring it down to a later period of time, on December 14, 1955, you wrote a letter to Mr. Fish in regard to the acquisition which is here marked in this proceeding as Exhibit 372. A. Yes, sir, I distinctly remember that.

Mr. Kurtz: At this time I would offer in evidence this Exhibit 372.

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Presiding Examiner: I think through inadvertence, or some such, it was already received.

(1319)

Mr. Kurtz: That is right, we had that discussion. I beg your pardon.

Presiding Examiner: Already admitted, Mr. Kurtz, this morning. I am sure that I said for the record that from 1 through 372 were received in evidence.

Mr. Kurtz: I was not thinking.

By Mr. Kurtz:

Q. There is one sentence in that letter, Mr. Kayser, that you mentioned, as follows:

> "In all events the merger must be carried out in such fashion as to require the order of the Federal Power Commission under Section 7(c)."

What were your reasons for wanting the merger to be approved by this Commission? A. That was always our desire in making this trade. We wanted to merge the properties, and you will notice that I call there for either a transfer direct or to a subsidiary. Now obviously, if you transfer it to a subsidiary, we could immediately apply to the Commission and transfer it to the company.

Q. And at the time were you concerned with the possibility of the Justice Department objecting? A. Well, we wanted to do it that way, irrespective of

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the Justice Department, but it was perfectly apparent that from the standpoint of avoiding any possibility of trouble that was a better way to do it.

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Q. Well, let's come back to this Big Piney area.

At the present time—well, I say "present" in relation to time—on November 14, '57, you entered into a gas purchase contract with the Belco Petroleum Corporation.

In fact, on that same date, there were six different agreements with Belco Petroleum Corporation and Belfer Natural Gas Company.

Is that right? A. Right.

Q. Anyway, how did it come that you took the contracts

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in the name of El Paso? A. Well, one: We had a much better trading atmosphere and position, that we traded direct with Belfer for ourselves, El Paso, instead of around through Pacific Northwest. There were a lot of reasons for that. I do not want to mention all of them.

The other was that in that connection, we were, well, I would not say the whole thing—but a very large part of the transaction from the standpoint of Belfer with the advances in aid of drilling development that he desired to get; and, obviously, El Paso was in a position to do that while Pacific Northwest was not.

So, taking all those things into consideration, it facilitated the culmination of the transaction for us to deal directly. And, as you see, if you ever dealt with Mr. Belfer, you would know what I am saying is perfectly—is fair to him in everything—but it always gets complicated before you get through.

Q. I gathered that from the agreement. A. It runs into a number of contracts before you get out of the house.

Q. I was also interested in the fact that I believe you are starting to pay 17 and a half cents per Mcf for that, and I believe Pacific was buying gas from him at a lesser price.

Am I correct?

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A. That is correct.

The contract was made at a time much prior to the negotiations we were talking about.

Q. Why did you offer to buy it at a higher price? That is what I meant. A. Because we simply could not buy it any other way.

Q. There was no one else in that area to purchase the gas, was there? A. Oh, yes; there were a lot of people offering to buy that gas.

Q. Who? A. Tennessee was offering to buy it, was negotiating for it; and one or two others. I do not remember who it was.

Q. You mean Tennessee Natural Gas Company? A. Tennessee Gas Transmission. That is right.

That is what Mr. Belfer told us unconditionally, and I am sure they were there.

Now look——

Q. I am not doubting your word. I am just a little surprised, Mr. Kayser. A. Well, so was I. But, nevertheless, the situation was this: that Mr. Belfer is a very optimistic gentleman, and he told me, in part, that he had an excess of 200 million feet of gas a day, that all we had to do was make a contract with him and lend him some money, advance him some money, to

drill it up, and he would lay it on the line. And he was so convincing—until we signed contracts for that amount. It is either 200 or 250, I forget which. But I know it is 200. Now, that is a lot of gas, and you can do a lot of things with a lot of gas like that; and we needed it, and we would like very much to have it.

We signed the contracts, and we have advanced already some substantial amount of money.

Q. And I gather from that that you think the gas is there? A. Oh, not now. I did for a time, but after a number of wells were drilled, it was perfectly apparent that there was not any 200 million feet of gas there.

There is some. I think there might be 40 to 50 million feet.

Now, you never know. Maybe later, the next wildcat that is drilled on the edge may open up a trend that can produce the 200. I do not know. But today there is not. It is problematical how much we will get out of it, except we will get our money back. We have that hung into one half of that that is developed, and enough has developed to pay our money back. We are not afraid of loss. But we are not at all optimistic about being able to get anything like the quantity that caused us to make the contracts.

Q. Well, did he mention any other pipeline companies?

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I am just curious A. Well, he talked so fast, until I do not remember at the moment.

Q. Now, getting back to this:

What effect will that have in this area, upon your future purchases of gas, and also what effect will it have upon your existing contract? A. Well, we are not planning to take any of that gas at that price.

Q. I do not follow you. A. We do not have to.

I mean, the contracts run out shortly. And we have had conferences about it, and, while we are studying it further, and under obligation to go ahead and study it further, I think the true fact about it is I do not think there is going to be enough there that will justify our proceeding under that contract.

Now, if it were there, why, I would be coming right back here and asking you to let us buy it at that price. We think that is the thing to do, if there were the quantity. But I think that part of it has fallen down.

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Q. From what you just said I gather you at that time considered the Pacific line as not a feasible project, and at that particular period of time, in February of 1954, did

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you make an offer to buy the gas from the Belfer Corporation, in which Mr. Belfer also wanted certain advances of money for drilling operations? A. Yes. Well, there again there was that same optimism. At that time it was justified.

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Q. Yes. A. As to the size of the reserves. And I am sure that I negotiated not directly with Mr. Belfer because I did not meet him at that time, I am really sure. But through an intermediary I had negotiations with him and we indicated a willingness to trade on the basis of making some substantial advance on some kind of a farm-out deal with him. And I was sorry that he didn't accept it because it turned out to be a very rich area.

Q. What I have reference to is that Pacific's contract was also subject to renewal in that same month of February of 1954, was it not? A. I think that is correct. As to whether —yes. It was certainly up shortly.

Q. Yes. A. That I am sure of.

Q. Now, at the present time in the San Juan Basin Southern Union is also taking gas out of that area, are they not? A. Yes sir.

Q. And approximately half of the gas that is produced by Southern Union you are buying, is that not correct? A. I don't know the figure.

Q. You are buying gas. A. We buy their surplus, I can tell you that.

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Q. Pardon? A. We buy their surplus above their needs. I am sure of that. And it is substantial.

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Q. Now, let us get down to the present time, Mr. Kayser. At the present time you have competition in the Permian

Basin from the Permian Basin Pipeline Company, I believe is the principal one, do you not? A. Yes, and the Transwestern, of course, has been making contracts and has the contract.

Q. Yes. That is right. A. And Lone Star is in there likewise, you know. Lone Star is on the eastern edge of the Permian Basin.

Q. Well, actually while Lone Star is in that area, they are not increasing or seeking increased volumes of gas out of there, are they? I am thinking of the present supply picture, Mr. Kayser. A. Well, they are taking gas out of there.

Q. They are taking gas. A. That is right, and——

Q. But you are not counting—— A. As to some particular points that are right around

them, they buy it away from us. That isn't important. I am willing to tell you that that isn't, but it is actual.

Q. Yes. A. Now, I think Pioneer buys some gas. I believe that is correct. Pioneer is a distributor in that area, a substantial one, and we sell them substantial gas. Now——

Q. Pioneer I have never heard of. What does that do, is it a distributing company? A. Pioneer Natural Gas Company that distributes gas in an area as an intra-state operation.

Q. Is the volume large? A. Substantial.

Q. What do you mean by that, approximately? A. Oh, we sell them some 20 million or 30 million feet ourselves, I am quite sure.

Q. A day? A. Day, yes. And they must be delivering 75 to 100 million a day, I would think. I haven't ever looked at one of their statements, but it is quite a nice operation.

Q. Now, at the present time I believe that the Permian Basin Pipeline Company has been offering and have entered —well, has entered into a contract in Winkler County,

Texas, which is within the Permian Basin, for 16 cents. Are you familiar with that? A. I think that is correct. I am not personally familiar

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with the exact contract.

Q. Well, my interest is what effect will that have upon your future purchases in that area? A. Well, it just makes it harder to buy at that price. That is all there is to that.

Q. Well, you are not offering 16 cents for gas at this time, are you? A. No, we are not.

Q. Do you think anybody else is going to sell you any more gas unless you meet this price? A. Don't crowd me too much. We are negotiating all the time and we are buying some gas.

Q. I don't mean to embarrass you on any of your negotiations. A. Well, that is all right.

Q. But generally, let us put it this way. When the price—when a person enters into the area and offers a certain price for gas, generally everybody else has to meet that price. A. Exactly, sooner or later. That is the size of it. There is nothing else you can do about it.

Now, there are other compensating factors. We have had the fact that we were there and could take gas in larger quantities and faster than most anybody else. That has helped us, but that can't hold the line forever. That is the way that is.

1356

Q. So we get this in the record, Permian Basin Pipeline Company is a subsidiary of Northern Natural Gas Company, is it not?

A. Yes. That is right. And they have a substantial, a very substantial market, of course, but I think we buy it faster and move it faster, I think. Now, maybe we are just bragging, but——

Q. I am not questioning that at all, but Northern Natural is a big company. A. Oh, it is a very substantial and very fine company and has done an excellent job, and the truth is that they are moving more than 300 million a day out of that area right now. I think that is about right. It is more than 300 million.

Q. And likewise you are faced with increased prices in the Anadarko Basin, too, are you not? A. Yes.

Q. And in time they will affect your prices. A. Yes, sir.

Presiding Examiner: What basin was that, Mr. Kurtz?

Mr. Kurtz: Anadarko Basin.

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Q. You mentioned competition with the Trans-Western Pipeline Company. The Trans-Western Pipeline Company is offering price for gas substantially in excess of what you are paying for gas in the Permian Basin, are they not? A. That is right.

Q. And if that certificate is granted, can you—will your prices of gas go up in the Permian Basin? A. No. We haven't what is known as the third party escalation. Ours is only if we pay more.

Q. If you pay more. A. Yes. But I am not going to dodge the implications of it.

Q. What? A. I am not going to dodge the implications of it. Sooner or later we are going to have to do something about that or not get the gas.

Q. You will have to meet any competitor's price there sooner or later. A. If you want to buy any more, yes; sooner or later.

1362

Q. I think we went into the Aneth Field which is up near the San Juan, and the various relationships between price there. But substantially the resistance that you met from

the producers was the fact that Transwestern had offered 20 cents in that area. Isn't that correct? A. Well, that is part of the fact, but the fundamental factor is that the gas involved in the Aneth Field has not only gas in it but it has a great deal of liquids, and the contract that we made in the division of the quantity of liquids that we gave back to the producer versus the quantity that we kept for ourselves, and the price that we paid for the residue, the gas we actually get at the discharge side of the plant, those two things were put together and the price at the discharge side was 20 cents but the percentage of the liquids that we kept was I think 17 cents. I think that is right. And it was in all events sufficient to pay for the gathering, extraction of the liquids, and compression of the gas up to 850 pounds, I believe it is, and make us 6½ per cent on the investment to do those things. So that we got the gas on the discharge side of that plant at almost exactly a net 20 cents. 100 million at one spot. All right. In the entire San Juan Basin, we couldn't do that and were not doing that well, paying 12 cents at the mouth of the well. Therefore, that gas was worth more and it didn't hurt my conscience nor my business attitude, the

principles about it, to pay it because it was worth more because we could get it to market at a little less than the cost we were putting the other to market.

Now, that is a special situation and it wasn't just upping the price. The gas was worth it.

Q. All right. Of course, the companies you were dealing with are major companies and they were well aware of that, too. A. They certainly were.

Q. The worth of the gas. A. They certainly were.

Q. If there hadn't been another offer, though, of 20 cents in the contract entered into with Superior, you might have

bought that at 17. That is just that possibility. A. Let us analyze that a minute.

Q. That is what you offered, wasn't it, at first? A. We offered I believe 14 the first crack. We didn't do so well. But here is something you want to remember now in that connection.

That gas is only about 450 miles from California and it is possible 100 million feet of gas can be transported 450 miles without too much transportation cost. Now, those companies had uses for the gas themselves. They could burn it. In addition to that they could build a pipeline over to California themselves and they had that in mind. They said so.

1364

They testified that they had that in mind.

Now, in addition to that you have got to remember that they themselves, some of these companies, The Texas Company in particular, were selling gas to the Southern California gas companies at prices ranging from, I believe it was, 22 to 45 cents.

Q. That is in California. A. In California. Which makes them entirely sophisticated as to the value of that gas and its relationship to the market.

Q. So it took 20 cents to get the gas and you bought it. A. We were very glad to get it because it would not affect the price that we would have to charge the California people for it, and we bought it. We hope we keep it.

Presiding Examiner: What field is that now, the Aneth?

The Witness: The Aneth at the Four Corners up there.

Presiding Examiner: Yes. I know where it is located.

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"August 27, 1952

Mr. Henry Gallert
Seattle Gas Company
Seattle, Washington

Dear Henry:

On leaving Seattle on Friday for my meeting with John McGuire we dropped by Westport, Washington, and went fishing Saturday and Sunday mornings and then flew into Salt Lake City Sunday night. Incidentally, we didn't catch any fish but had quite a boat ride.

John McGuire phoned me that it was necessary to delay our meeting on account of the Aunt that raised him being in the hospital and very ill. I therefore continued on home and arrived here Monday evening. Since then have talked to John on the phone again and we have a meeting set up just as soon

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as his situation clarifies itself. He is now in Lowell, Massachusetts and expects to be back here by the end of the week.

In the meantime, Dick Williams has been, together with our attorney Binford Arney, preparing a skeleton application in accordance with arrangements made by Arney and the staff of FPC. Apparently, the arrangements included that the application would be sent to the FPC, immediately followed by a visit by Arney and then the filing of the formal documents. This was further influenced by the pending negotiations with McGuire which, of course, can completely change the engineering and other data. I am not personally too familiar with the arrangements, but according to Williams and Arney everything is set up on a satisfactory basis with the FPC.

I intend to personally stay right on top of the McGuire deal until we either have or have not made a trade, as it is one of the most important aspects of the over-all deal. In

the meantime, we are still closing in on negotiations on several other blocks of acreage in the San Juan Basin although the situation there is really getting competitive, with both Kayser of El Paso and Colorado Interstate laying really serious money on the line and paying prices for gas considerably higher than what we have so far paid.

On my way back, while in Salt Lake City I had a visit with Mr. Edward Lindsey of the law firm of Hanson, Kelser &

1369

Hanson. Lindsey's partner is one of the Public Service Commissioners of Utah. I gave him the complete run down on our proposition, which is sold on. I was amazed at his rather broad thinking on the deal. Lindsey is a friend of Jim Bell's; they both having gone to school together. Lindsey's thinking is similar to ours, that the destiny of the Intermountain area encompassing Salt Lake City, the Southern part of Idaho and the Pacific Northwest is closely tied together and is in direct competition with California; that Northern and Southern California at the present time dominate the situation and that natural gas will contribute in a major way to make these areas competitive with Northern and Southern California. Will send you copies of my letter to Lindsey and also copies of my letter to the Public Service Commission.

As soon as we complete more details on our project, such as either making the McGuire deal or tying up more acreage so that all bets are covered will plan another trip to your country to make more of the people cognizant of what natural gas will mean to the area.

Very best regards,

THE FISH ENGINEERING CORP.
Ray Fish

RCF:jd

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By Mr. Kurtz:

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Q. What I would like to have you do, Mr. Kayser, is bring us down to date upon this proposal at Kingsgate. A. The Conservation Board of Alberta has made its report and has found a certain amount of gas to be surplus to the needs of the domestic market. The amount of that gas is less than that that has been applied for by Pacific Gas and Electric Company through its Alberta Southern company and Westcoast for the account of Pacific Northwest—El Paso contract.

PG & E applied for about 450 million a day, and Westcoast 150 million.

Now, the Canadian authorities proper did not want the project to be burdened with the construction of duplicate facilities, neither in Canada nor in the United States. So, at a conference held with those authorities—I will just give you the net; there is no use in giving the details of the contracts—Pacific Gas and Electric Company agreed with Westcoast Transmission to organize a Canadian corporation and each would take one-third of the stock of that Canadian corporation, and the other third would be sold to the Canadian public; and that that Canadian company would build a pipeline and operate it from what is known as the Crow's Nest Pass on

1404

the Alberta-British Columbia Border in the very extreme southern portion, southwestern portion, of Alberta, and southeastern portion of British Columbia.

From that point known as Crow's Nest Pass to Kingsgate, a point on the Idaho-Canadian Border—that will be a

34- or 36-inch line—I do not know. Thirty-six, I guess it is—and it will transport gas for the account of the Pacific Gas and Electric Company's subsidiaries or for their account, whatever they want done, and will transport gas for the account of Westcoast which, in turn, will be delivered to Pacific Northwest at the border at Kingsgate.

1405

Now that, of course, avoided the duplication of facilities for that 105 miles from Crows Nest Path to Kingsgate. That was, to my notion, a very constructive thing to do. We think that it is a particularly helpful thing to us because through Westcoast we have what you can say is almost a permanent access by transportation from the Alberta reserves down to Kingsgate at that point, and on the most economic basis that that can be moved at this time, taking into account the amount that is available for export. Now then from Kingsgate on down to Spokane we agreed with Pacific Gas and Electric, under the same suggestion of the Canadian authorities, that it would be a constructive thing for them to go ahead and build the pipe line from Kingsgate down to the California border, California-Oregon border, a point close to Klamath Falls, and to transport for us whatever gas we got in at Kingsgate down to Spokane, so we would not have to build that duplicate facility from Kingsgate to Spokane.

You can see all of that on the map which is Exhibit No. 1 in this proceeding.

Q. Just at that point, do you mean that P.G. and Electric, from Kingsgate, will build a line from there, say, to Klamath Falls? A. Yes, that is their proposition.

Q. I meant, all the way up, the 36-inch line?

1406

A. That is what I understand their proposition to be now. Now I am quoting from memory on that. I think that

is correct. And they would transport for us from Kingsgate down to Spokane.

Now we have taken up with them, which I think is going to be all right, they have indicated that they thought it would be all right, in fact I already have—well now, wait a minute, we have not got absolute agreement on it, but my judgment is from the conversation that I have had, that there is no objection to doing it—that we should have the right to take off from that line, all the way down to Klamath Falls and at Klamath Falls, varying amounts of gas to the extent, of course, that we would put it in at Kingsgate and have it for that purpose. That will enable us to serve the Oregon area much more economically than could otherwise be served, that part of the area that is adjacent to the Pacific Gas and Electric Company's line as it goes down across Oregon from about Pendleton to Klamath Falls. That we think, again, is a very constructive thing to do. And we feel like we have, in the main, accomplished the objective that we started out with in getting gas out of Alberta.

Q. Well in the operation of that, and your line from near Pendleton, Station No. 14, up to Spokane, then if you take gas in at Spokane, will that reverse the flow of that gas?

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A. Yes, that will reverse the flow. The calculations have already been made, we have run the engineering, and what we propose to do in our original application to the Conservation Board, rather, in support of Westcoast's application to the Conservation Board, we propose to build a 30-inch line from Kingsgate down to Spokane to move 150 million feet. But when you got to Spokane, in the area around Spokane, you took off enough of it so that the remainder could come down through that 16-inch line when you reverse the flow. And that is a high pressure line, a 16, and I do not remember the exact amount it will carry, but

I did answer a question propounded by the counsel for the Board and verified my answer, that that 16-inch line was sufficient to take the remaining part, after you serve the Spokane area, on down into the system of Pacific Northwest. But we have a better arrangement now with Pacific Gas and Electric because we already have their own agreement, I mean their own suggestion, that they would give us a takeoff at Pendleton where they cross. So that under no circumstances will we be short of capacity to move the gas down to Pendleton.

Now another thing I want to make clear on this record, because I want it to be perfectly clear, Pacific Gas and Electric was just as reasonable as they could be in regard to the necessities that we would be under, that we could not afford to make a contract for just, we will say, 300,

and that is what it is, 300 million and stop there, we would have to have the right, that if our requirements went beyond that, we would have the right to give them notice, and on proper notice cancel that contract, take back our gas for our own pipe line, which is a very constructive thing.

In other words, we are not limited, we can do whatever we are able, so to speak.

Q. I do not quite follow that. You say take back the gas. At the present time you contemplate 150 million through Kingsgate, is that correct? A. That is right.

Q. Now that is to be stepped up in the future? A. It can be stepped up to 300.

Q. It can be as it becomes available? A. Right.

Q. Now out of that first 150 million to be imported at Kingsgate, what part of that would be P.G. and E., and what part would be Pacific? A. No, there will be roughly 350 that will come through there to start with. Something less than 150 initially will be ours.

(1408)

Q. I see. A. And the balance will be Pacific Gas and Electric. Now the point there is that when our demands, if they do, exceed the 300 million, then we can give them proper notice.

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I believe we have already said we would not give them that notice for two or three years, I forget which it is, because we can not see where we would want to, and they need to be able to plan it over a period. But they properly figure that if they have sufficient time they can plan to drop that off to us and let us pick it up at Kingsgate, instead of picking it up at Spokane.

Now of course, obviously, we would never do that as long as they could more economically provide the space in their 38-6-inch line. We do not want to just spend money for pipe line.

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Q. And as I understand it, this 150 is either to be dropped at Spokane or to be dropped at Pendleton? A. Part and part.

Q. In part. A. And we are negotiating, and I am sure we will get it, the right to drop some of it off clear down at Klamath Falls, and on the way down to Klamath Falls so as to serve those communities in Oregon that can be economically served from that pipeline. I think that will happen.

Q. Now all of this right now is in the formative stage? A. Except that we have specific agreement now covering Spokane and Pendleton, and in the conversations it was suggested that we should raise it on up, I mean, make it cover all the way down to Klamath. Now the detail of that has not been agreed on, and it does take some agreeing on detail. But the agreement is firm on our not building the 30-inch line from Kingsgate down, but that they are to build their entire line and transport for us, giving us a takeoff point, first, at Spokane and then at Pendleton.

Q. At what price will they transport for you from Kingsgate to Spokane, and also at Pendleton under this agreement? A. At cost of service based upon the amount, the proportionate amount, of pipeline that would be used by us.

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Q. Well, what figure are you thinking about as the cost of service? That is what I am interested in. A. I do not remember it. We were not concerned with it because, obviously, the cost of service of moving 350 million would be less than the cost of service of moving 150. And we have made the calculations. I do not know what it is.

Q. Do you have a copy of that agreement with you? A. It is merely in draft form now and has not even been signed, but it is perfectly definite and I have had—I might say that it was made at the suggestion of the Canadian authorities—we just do not want any duplication of facilities coming out of Canada if we can help it.

Q. Well the cost of 150 million at Kingsgate from Westcoast is how much? A. How is that, I did not get you?

Q. The cost of gas to you of this 150 million that we are talking about at Kingsgate is how much? A. It is calculated to be exactly 27.91, but we call it 28 cents.

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Q. Mr. Kayser, in response to a letter dated May 9, 1958, from the Commission to the El Paso Natural Gas Company, you filed your response designated the Sixth Supplement to the original application in Docket Number G-13019, and one of the requests in that letter is as follows, and I am reading from

1415

page 23 of Book I of the Sixth Supplement, tenth request:

It is stated on El Paso's application that no change is proposed in the filed tariff rate as a result of the

merger. It is also stated that all resulting reductions in the surviving corporation's cost of service must inevitably be reflected in its rate structure. Please indicate if these statements are to be interpreted to mean that El Paso after the merger will not seek to increase rates to its customers of the Pacific system based upon the present net income derived from the Pacific system. With respect to the cost of service, submit for the surviving corporation the information and supporting data and so forth requested by the rules.

And the response:

Answering the inquiry made in the first part of this question 10, application did not intend by the language used to indicate that it would not seek increases in rates to the customers of Pacific Northwest system in the future necessary in order for applicant to earn a fair rate of return upon such property. It did intend that it is not seeking any change in the rates in this application nor in the immediate future. Obviously, in any future application for rate increases, the economies resulting

to the surviving corporation by reason of the merger will necessarily be reflected in the cost of service studies filed in any such rate application. In view of this answer, the sections of the regulation referred to in the latter part of the question do not apply.

Now, is that still your same position? A. Yes, sir.

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Paul Kayser

resumed the stand and testified further as follows:

CROSS-EXAMINATION

By MR. BENNETT:

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Q. Now, when did you conclude that El Paso should acquire the Pacific Northwest System? A. Well, to answer that exactly, Mr. Bennet, I believe that the answer would be in August, September—well, to tell you the truth, it only occurred at the time that we were able to trade it out on a basis that we were satisfied with, which was somewhere around September or October of 1956. I

1429

think that is right. I know that is right.

Q. Now, prior to that date, had your company ever given consideration to the acquisition of Pacific Northwest? A. Oh, yes, as we testified and as the record abundantly proves, from way back as far as 1954—I'll put it this way now. It was always a matter of interest to us, from the time we made the connection with the Canadian gas. Up to that time, as I testified yesterday, we not only were not interested in buying it, we didn't think it ought to be built.

Q. What were the reasons which prompted your interest in acquiring Pacific Northwest initially? A. I would say that the first impulse that we had to it was generated by the potential of reserves in Canada. Now, I'll be frank about it. It has turned out that the potential of the Rocky Mountain region was much greater than I thought it was. But if you go back to the history of Canada, you will find that—I don't want to use the word "ballyhooed;" I won't

use the word "ballyhooed" in that connection. I'll say that it was tremendously advertised throughout the years 1952, '53, '54, '55, and on, and it still is. But it had a big play in '51, '52, '53.

Q. Was there any other reason? A. No. You asked me what first did it, or stimulated me. That is correct. Then later, the potential of the Rocky Mountain region had something to do with it. Substantial.

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Q. The only reason, then, which prompted your interest in acquiring Pacific Northwest's system was the potential reserves? A. That is right.

Now, what we would do with it was tied into that, obviously. We had tremendous demands for gas, and that represented the most economic way, the most normal way, suggested geographically and economically to supply those demands.

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Mr. Bennett: Mr. Examiner, I would ask that you instruct the witness to answer from his memory; that is all I want. I don't want the minutes of this meeting.

Presiding Examiner: The witness has indicated that he cannot answer from his memory.

Here is what I understand the position of the witness to be:

He recalls as a fact that there were many meetings at which this subject was extensively discussed.

Now, when you ask him to pinpoint, as he said, one meeting

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at which one particular matter was decided or discussed, he is telling you that from memory he cannot do so. And I

think it is unreasonable to demand any such thing from a witness.

Mr. Bennett: Very well, then.

Presiding Examiner: I'm confident that I couldn't do it. Of course, I am a man of limited capacities, myself.

By Mr. Bennett:

Q. Well, now, do you recall at a single one of these meetings, at any one of these meetings, whether or not with reference to the acquisition of Pacific Northwest there was discussed anything in addition to the reserve potential of that area? A. I'm sure that in our discussions, as we have already indicated, we discussed the market prospects of Pacific Northwest, the area served. I'm sure that, likewise, we discussed the route of the pipeline, the roughness of the terrain, instances like that. That I remember quite clearly, but not on any particular meeting. I'm not willing to pinpoint that at any time.

Q. Do you recall whether or not at any of these meetings you discussed the possibility of eliminating Pacific as a competitor to El Paso? A. Not at any time did we talk about the elimination of Pacific as a competitor because—well, I won't give any reason. I'll just say we didn't.

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Q. Did you discuss at any of those meetings the possibility of eliminating Pacific as a potential or future competitor? A. No, that wasn't what we were interested in, Mr. Bennett. That wasn't the topic of discussion.

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Q. Now, from your memory, how many meetings would you say that the El Paso people and yourself had concerning the acquisition of Pacific Northwest, from the first meeting back in '54 to the present date? A. I couldn't possibly

tell you that, Mr. Bennett. I just haven't got any memory on the number of meetings.

Q. Well, could you—— A. No, I wouldn't guess. I have no interest in trying to guess, and I can't guess accurately, and I am not going to guess.

Q. Maybe I can help you in this regard. Would it be possibly 100 meetings? A. I have told you I wasn't going to guess. I am not going to say if it is 100 or 1,000 meetings.

Q. Well, ——

Mr. Shannon: I don't want to interrupt. I think the number of meetings is immaterial, Mr. Examiner. We have had every aspect of this acquisition fully covered in the record. It doesn't make any difference if they have five meetings or ten meetings; we have gone through all that.

Presiding Examiner: I don't know what Mr. Bennett is driving at. I don't know what he wants to bring out. I think he has the right to establish, if this be his purpose, as to just when it was determined to negotiate for the acquisition of Pacific Northwest. He has the right to establish that, and

if there was any thought of eliminating competition, he has the right to ask that. He has asked it, and the witness has answered it.

Now, as to just why we must have the information about these minutes—about these meetings—I'm going to ask the witness this. I assume they were both formal and informal meetings on this matter of acquiring Pacific?

The Witness: That's right. It is already in the record about two directors' meetings, anyway. I'm not sure whether there were any other directors' meetings dealing with the discussions leading up to the actual trade that was made in '56. Now, I don't know; maybe there is.

Presiding Examiner: If there were, the record would so indicate?

The Witness: Yes, and I don't remember, and I don't know.

Presiding Examiner: That is what I referred to as formal meetings, meetings of the Board of Directors. Now, there is a fixed record of meetings of the Board of Directors to which we can go, and then there is no question about it. Now, these informal discussions, as I classify them, or with other officers or with the directors informally, there may have been some of those. Go into that if you wish, but let's get down to the point where this witness can talk about the things that occurred there, and not at some particular meeting.

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Now, you have got the right to ask about the questions you have just asked about, but I don't think you can pin the witness down to one single meeting on the 27th of June, or anything of the kind.

The Witness: I would rather be frank with you than not, but I'm being frank with you when I say I couldn't any more remember and tell you about a date on which I sat down with Mr. Steen or Mr. Norwood or with Mr. Boyd. I couldn't do that. Our business, of course, is a fast moving business, and we have continuous talks, on the telephone, together in the office, at various places; New York, Houston, El Paso principally, and then we have telephone conversations, of course, back and forth between them. I'm perfectly willing to say to you that we discussed it many, many times as a part of the business, and that is as far as I can go.

Presiding Examiner: If I may interrupt to ask just one more question. I call those informal discussions with officers with whom you have had these discussions.

The Witness: That is right.

Presiding Examiner: I assume those discussions were held from time to time beginning in 1954, when the idea of acquisition was first conceived, down to 1956, when it was consummated.

The Witness: Off and on.

Presiding Examiner: That is what I mean; not continuously

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or constantly.

The Witness: That is right.

Presiding Examiner: I think you can ask the witness about any of those, any subjects that were discussed by him in the office.

By Mr. Bennett:

Q. Confining ourselves to the so-called informal meetings, of which I gather there were many, at a single one of those, to your knowledge, was there discussed by El Paso people the question of eliminating Pacific as a possible or actual competitor? A. No, I have no memory of having discussed that phase of it, because that wasn't what we were interested in.

Q. Then it wasn't even mentioned at all, to your memory? A. Well, no—well, I wouldn't say that, because you had a legal problem of antitrust. It has been in there since the first day the matter opened up. Naturally, competition would arise in that connection. Such discussions as we had with attorneys in that respect—now, I'm perfectly willing to tell you what I said. I can remember it perfectly clearly. I don't know that you want me to tell you.

Q. I take it, then, your answer is that was in the realm of your knowledge, there was never discussed at any informal El Paso meeting the possibility of eliminating Pacific as a

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competitor to El Paso? A. Not as an object of our acquisition.

Q. Was it discussed in any way?

Mr. Shannon: Just a minute; he hasn't answered the question.

The Witness: Wait a minute; let me answer that. As a thing of interest, of legal interest, as to whether prosecution might arise, that was discussed. My position was, and still is, that such competition as you might—well, in the first place, they go north and we go west and south, and we didn't have points of contact except in the one spot in the San Juan Basin. We didn't regard that competition as controlling, and we had from the very beginning, now—let's understand this—from the very beginning, we had become interested in Pacific Northwest in order to be able to get connection with the Canadian gas and such other gas as they might be connected with to jointly put it to California. That is our history, and it is as clear as life.

1442

Q. What reserves in Canada did Pacific Northwest control, to which you wanted access? A. Well, let's see now.

When we became interested, we had helped them negotiate themselves into the position, get themselves into the position, of being able to make a contract with Westcoast. Now, we did not—I did not—negotiate the contract with Westcoast. But we helped get Pacific Northwest into that position.

What I mean by that is that we made a contract that we were ready to sign whenever they got the contract with Westcoast: that we would take 250 million of it off their hands at Mountain Home.

Now, they couldn't have gotten started to Canada without that contract, and we did that. That was a joint enterprise, to get the gas over to California to satisfy the market.

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Q. Now, when did it become apparent in your operation of the properties of Pacific as a subsidiary, that the two systems could be more efficiently operated by integrating them?

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A. I believe I have already testified that that began to be apparent to us within a matter of months after we acquired it and became responsible for its operation.

Q. Would that be two months after the stock exchange and acquisition date? A. At least.

I mean, within those two months, it became apparent to me that there were more problems in relation to trying to keep it a separate corporation than I had previously anticipated.

Q. Well, did you have some kind of a study upon which you based that determination? A. No, I based it from my experience and my knowledge of its operation and the operation of the El Paso company.

Q. Well, did you, yourself, make a study of the Pacific system before coming to this conclusion? A. No.

Q. Were you advised by any of your engineering staff, for example, that an integrated system would be more efficient? A. No.

Q. Did you employ any management consultants, who advised you toward that conclusion? A. No. We didn't need them.

Q. Well, now, operating through a subsidiary can be an efficient operation.

Hasn't that been your experience?

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A. Yes, where you simply consider the corporate entity as a form.

Wherever you try to preserve discretion and independent financial operations in a subsidiary, you have a problem.

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Q. Mr. Kayer, you testified that the appeal which lies in the merger, so far as you are concerned, rests in the fact that the merged system will have access to all fields that

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have presently developed reserves and all potential areas that are within economic reach of the market. That is your testimony on page 68, lines 11 through 15 thereof. A. Yes, sir.

Q. Now isn't it a fact, Mr. Kayser, that even without the merger, you will still have the same access to the same reserves. A. No, sir.

Q. You mean despite the fact that you have almost 100 per cent control of Pacific, you will not have access to these same reserves? A. No, sir, because as I testified, I believe this morning or yesterday, if the Commission should deny the merger, there is no practical way for us to continue the operation of the Pacific Northwest as a separate corporation. We would not be willing to try to do so.

Q. You say you would not be willing to try to do so? A. Right.

Q. Is there some legal disability standing in the way of an effort to do so that you know of? A. Practical difficulties as well as legal difficulties.

Q. What legally would prevent you from operating this as a subsidiary? A. In the first place, of course, there is pending the suit, and if this Commission should find that the merger

1677

of the two companies is not in the public interest, why I do not know what we would say to the court. But that is a practical matter. Maybe we have got plenty of legal things to say, but I am dealing with the practical side of it, and I do not know how we could, as a practical matter, operate these two companies in such a way as not to incur civil suits, I mean, civil suits by individuals who would claim that we had injured them by violating the antitrust laws, and further suits by the Government in respect to the same thing.

Q. Well now, confining ourselves first to the legal aspects

(1677)

of this proposition, aside from the antitrust action in the District Court in Utah, is there some other legal reason why these two systems cannot be operated independently, or integrated as a subsidiary. A. It is not dependent on that suit alone, it is dependent on the fact that we would be accused in later complaints and suits of having violated the antitrust laws in our operation of the company along through the years.

Q. By whom? A. By anyone who felt themselves agrieved.

1678

Q. Well, have you experienced that difficulty with reference to your Utah Natural Gas Company? A. It is not in the same position.

Q. Well, have you had any complaints filed against you with reference to that company? A. We have had some criticism. I do not remember it at the moment, but it was not serious.

Q. Was it in the form of a complaint filed in some jurisdiction? A. It was not.

Q. Well, that possibility exists with reference to the Utah company, does it not? A. And we have been considering merging.

Q. Well now previously you told me you did not know whether you were going to merge or not. Is that still correct? A. That is still correct, it has not changed since 30 minutes ago.

Q. How long has the Utah company operated? How long has it been in existence? A. I do not know. The record is clear on it. '55, I believe, or '56. I am not absolutely sure.

Q. And to date you have not had a single complaint based upon antitrust law provisions filed against your El Paso or Utah because of it, have you? A. No.

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Q. With reference to any of these other corporations you control, have you had any complaints filed against a single one of those because of the antitrust law? A. Yes, we have.

Q. Which ones? A. El Paso Natural Gas Products Company.

Q. And when was that filed? A. About 60 days, maybe 45 days, ago.

Q. Any other corporations concerning which like activity has been taken? A. No, I am sure that there have not been any other suits filed.

Q. Well now aside from—— Then the only legal difficulty which you have in mind is the fact that some citizen might elect to file a complaint against either or both of the corporations based upon some violation of the trust laws? A. I did not say that.

Q. Well what is your testimony? A. I said that we would run the risk, we would be continually open to civil suits by individuals, and we would be continually open to suits by the government, other than the Salt Lake suit currently, as we operate along through the years.

Q. You mean even after the conclusion of the action pending in Utah, you would expect the government to bring

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further antitrust actions against your corporations? A. It is rather optimistic to say we would expect that, because if the Commission decides this merger is not in the public interest I would rather expect the suit in Utah to result in divestiture.

. . . . . .

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A. I would expect, Mr. Bennett, to make it perfectly clear to you, number 1, that in high probability, if this Commission decides that it is not in the public interest for these

(1481)

two companies to merge, that we would lose the suit in Utah. I mean the high probability—I hate to say that, but I think that is exactly what it is, and we might as well face it here as later. That is number 1. That, of course, brings about the divestiture immediately.

Now you asked a double barreled question, let me answer it. Number 2, we already have been sued, under state law, with our Products company, and that is an ever-present liability when you are carrying on any actions that can be brought within the scope of either the state or the federal law. Now I would assume that even if we should win the suit at Salt Lake under the national, I mean, the federal, law that we would be fair game to another administration, or the same administration, based upon some act that we committed, or performed, in our attempt to operate these two companies separately, and under one management, though the Commission has said that their merger was not in the public interest. Now that is, so far as the national law is concerned.

So far as the state law, it is apparent that our flank would be open. We operate in a lot of states.

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Now in addition to that, Mr. Bennett, there are provisions, both of the national law, so I understand, and of the state laws, giving to individuals who consider themselves to be aggrieved, or injured, or damaged, or their rights in any way abridged—those laws give them the right to bring suit, and we would be fair game for them, likewise, in all of the states in which we operate as well as under the federal law.

Q. Now to be precise about this, then, I take it that one reason you would not care to operate, merely through the device control or ownership, is because of an anticipated or expected, or apprehension that in the future the next

administration might bring an antitrust suit? A. I did not say that.

Q. Well, what did you say?

Mr. Smith: I object to the question on the grounds it has been answered.

The Witness: I would like to have it read.

Presiding Examiner: I do not know definitely. Let him answer the question, but let's get along without repetition.

The Witness: I did not say that alone, that is my answer.

By Mr. Bennett:

Q. That was one of the reasons you assigned, however? A. It was one of them. Sure it is, right.

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Q. Now you referred to some practical reasons why operation without a merger would not be feasible. What are the practical reasons? A. Well, those legal reasons raise the practical difficulties, but there are others, and I would like to state them right briefly. Number 1, there would be the worst kind of public relations, criticism for us, for various things that we did that the public might think was bringing about an imposition on one of the other companies by reason of the transactions that would necessarily have to be had between the two if we are to do anything like carry out the programs that we have been talking about.

Q. Could you specify something in that regard? A. Yes, sir. We made a contract between El Paso and Pacific Northwest. The general rule before the Commission is that that contract has no probative force, you have got to prove every single thing about it as fair and proper. Now you have got all the people in this room representing the various interests that would be sitting at that table, and I do not want—well, it is just as a practical matter you could not, it would be extremely difficult, to satisfy them all. And I do not want to—it is not practical to try to live under

those circumstances. Now that is one of the practical sides of it.

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There is still another important practical consideration that will be further covered by another witness than me; but I would like to allude to it, because you have asked me the practical difficulties. And those are the question of financing.

You have an extremely difficult situation, when you try to own all the stock of a company or practically all of it, and then finance that company separate from your own financing of the parent company. Now let me just tell you the practical side of it.

In the first place, when you go to either the public or to the insurance companies in private contract for money or the banks, it is true that the fact that a large, strong company who is the parent has a tremendous value on the credit of it, credit of the subsidiary; but you still pay a higher price and the difficulty is that if difficulty arises in respect to those debts, you are expected to step in and make good. So that you get, left-handedly, all the disadvantages and you get very little in the price of your securities that you can issue—advantages out of the subsidiary relationship.

Now, those are just practical things that occur in respect to financing.

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Q. Is there any other reason you care to give? A. Well, I gave the reason that in relations, public relations, part of which would come here before the Federal Power Commission, and could easily start and would start, would hurt our public relations, would be the fact that in the transactions between the two companies, where we made a contract

—I would think it would be almost impossible to make a contract, nearly so—not quite, but nearly—that would be satisfactory to everyone who was concerned in those two companies.

Presiding Examiner: You mean contracts between El Paso and the Pacific Northwest?

The Witness: That is right.

Presiding Examiner: As introduced—contracting parties?

The Witness: That is a situation which simply is in error, in any attempt to operate it as two companies.

Now I am not speaking arbitrarily nor capriciously.

We have already gone through all of that, when we sat down with our executives to try to work out a fair contract in respect to taking over the operation of the field facilities. We spent hours and hours and hours trying to fight that to be sure that, for instance, the present minority stockholders of Pacific Northwest would not be successful in a lawsuit that they brought against us in respect to that contract.

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Now, we have that in front of us every day.

Now, watch: If we bought up all of the other stock—we haven't got it all. There are some four thousand shares outstanding, and we have been absolutely unable to jar some of it at all—but, assuming you bought it all up, then, in any rate case, you have the same thing all over again with every one of your customers.

So, it just becomes—it just is not a practical thing to do. Life is entirely too short to be able to do that.

By Mr. Bennett:

Q. Well, Mr. Kayser, isn't any corporation subject to a suit by a stockholder? A. Yes.

(1491)

Q. So there is nothing particularly unusual about that reason; is there? A. Yes.

The circumstances under which I am talking about are peculiar and do generate such suits far more than the ordinary operation of a corporation.

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Q. Is that a reason why you cannot operate this as a subsidiary? A. That is one of them; yes.

Q. You consider that a valid reason? A. I surely do. And if you have ever gone through one of those lawsuits, you would, too. And I have.

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Q. You are the President of Western Natural and of El Paso, and you have directors common to both corporations, don't you? A. That is right.

Q. And you make contracts with Western Natural? A. With fear and trembling.

Q. How many contracts do you have with Western Natural? A. No more than we can help, and we are scrupulous to try to see that the contract hasn't got anything to do with it, that it is simply that the relationship between the two does not, never is tainted with imposition, either of one or the other.

Q. Could you—— A. That is a very, very delicate and very difficult thing to operate, and it is one of the reasons why I do not intend to get into it again.

Q. Could you give us the number of contracts existing between Western and El Paso?

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A. I do not know.

Q. Well has a single one of those contracts been attacked as to validity for any—— A. Yes, it has.

Q. And what was the disposition of that? A. Before the Commission? It was set aside as if it had never been signed.

Presiding Examiner: This Commission?

The Witness: Yes, sir. And before the court—I do not even remember all of what happened, but we had an awful time.

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Q. Well, now, Mr. Kayser, at one time there existed in your mind, did there not, good reasons why Pacific could be operated as a subsidiary? A. Yes, we thought that those reasons were sufficient to justify attempting to do it; and that it would be a practical thing to do.

Q. Now, were those reasons contained in some written report or study? A. No.

Q. Were they your reasons? A. Yes.

Q. And would you list them for us, please, if you could? A. Yes, I would be glad to.

Number One: We have always considered that as far as

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possible, the customers of Pacific Northwest should bear their proper part of the cost of that system.

Now I do not know whether you are familiar with this, or not, but the original certificate—that is, the opinion and order granting Pacific Northwest its original certificate—stated that one of the reasons why it was not granted to the companies that were asking for certificates to be supplied with gas from Canada was that; whereas, that gas was closer to the principal markets of Pacific Northwest, the the Commission found that it was not in the public interest that so large a part of the United States should be dependent upon a source for their gas outside of the United States.

Presiding Examiner: As a sole source, if I may correct you.

The Witness: Sole source is correct.

Now, consequently, in the interest of a stable service for that area, the certificate was granted.

Now the bringing in, to my mind, of the Canadian gas stabilized that whole situation. But those communities that are the beneficiaries of this dual source, including particularly the domestic source, should pay part, their proper part, of that cost.

Now that seems "A", "B", "C"—so, the keeping of it in a separate corporation would be helpful in that respect.

Now Pacific Northwest had its own financing, and at first

it seemed to me that it would be easier to just keep on with that company, with that financing outstanding, and develop it in that fashion.

I recognized at that time some of the difficulties. I also thought that it might be easier even to keep the two organizations separate from an actual operating standpoint.

Now I have found that the problems involved, the personnel and the problems of operation, were much greater than I thought they would be, and I have also found that when we came to grips with it—just as we did in trying to make the initial contract covering the operation of the field facilities—that it just went deeper than I thought it did. And the difficulties were greater.

By Mr. Bennett:

Q. Mr. Kayser, you say you did not have a written study concerning these reasons you just gave; is that correct? A. That is what I said.

Q. Did you, yourself, spend any extended period of time studying the Pacific system? A. Yes.

Q. Did you make a study of the personnel of the Pacific system? A. Not a detailed study.

Q. Did you make any kind of a study? A. Yes. I understood it.

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I talked with the people who were setting it up, and I talked with our people about what kind of a setup would be needed; and so forth.

Q. Was this before or after you had acquired the stock? A. Both.

Q. Now, did you also make a comparison, then, of functions that were being performed by Pacific personnel as against those which El Paso personnel were performing or could perform? A. Yes.

We looked that way—you pretty well have to do that, Mr. Bennett.

I mean, two pipelines regulated by the Federal Power Commission have a system of accounts and have an organization very similar in each instance.

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Q. Well, did you make a study to see which jobs were possibly being duplicated in the two systems? A. Yes.

Q. And what did you find? A. Well, we found, as would necessarily be true, that all of the jobs that we were doing, they would be doing likewise.

Q. And this was not in writing, this study or report? A. Oh, no.

Q. Well, how many jobs then did you find could be eliminated in the Pacific system? A. I did not say that. You cannot eliminate any of them. You have to do all of these various things, just like the accounting, the geology, the pipe line operation, the field operation, the control operation, the rate operation. All of those things have got to be done in both companies.

Q. Pacific has all of those functions, has it not? A. That is right.

Q. El Paso has all those functions? A. That is correct.

Q. Pacific is going to continue to perform those functions

with Pacific personnel? A. If it is a separate corporation, yes.

Q. And El Paso is going to continue to perform its functions with El Paso personnel? A. That is right, if it is a separate corporation.

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Q. Now was your study designed to see where there could be some elimination of jobs in Pacific perhaps? A. Oh, yes, by the merger. We made a thorough study of that. That has been presented. I do not know whether you were here or not, but it has been presented principally by Mr. Steen, I believe, the operating man.

Q. And was this study before you when you decided upon the merger? What was the date of the study—— A. Just a minute, let me answer that. No, it was not.

Q. The study was made after the merger? A. The one that has been testified to by Mr. Steen was made after.

Q. Or after the stock acquisition? A. Right. After the merger application, as a matter of fact.

Q. Yes. So you did not have the benefit of that study before you when you decided upon the stock acquisition, did you? A. No, I did not.

Q. Then that was not one of the reasons why you decided to acquire Pacific, at least any reason coming from what was in that study which you did not have? A. Well, I believe the lawyers call that a non sequitur, isn't that right?

Q. Well, regardless of what they call it, would you mind answering it?

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A. I would be delighted to answer it.

Mr. Standley: May it please the Examiner, Mr. Bennett is getting awfully argumentative.

Presiding Examiner: I do not think his questions are——

The Witness: I would like to answer it.

Here is the point. You asked specifically about the study. We did not have the study. The study spelt it out in dollars and cents, taking this man out and that man out, and coming down the number in each of these departments. We did not do that. But there was not any question in my mind that, just having operated this kind of a company for lots of years—and I do not stand off away from it, I am just as close into the operation as a man can be. Now it was apparent to me that some of those savings could be effected at the time we said that we still thought we ought to operate it as a separate corporation. I am just being fair with you. I mean, I could tell there would be some—without having made a detailed study—and put it down in third grade arithmetic.

By Mr. Bennett:

Q. Well how long did you yourself personally study the Pacific system with reference to organization, employees, financial structure and the rest of it? A. From the time we first started to consider the acquisition of the stock.

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Q. Did you yourself go to the Home Office of Pacific in Utah? A. Not for that purpose.

Q. Well, where did you make this study? A. Took the estimates of cost and so forth that were submitted to the Federal Power Commission.

Q. Where did you make the study? A. Probably in a plane, likely as any—that is part of my business, day in and day out, in El Paso, Houston, New York, with that data in front of me.

Q. You made it in a plane and in New York, you decided then there could be some efficiency—— A. No, I did not say that. I said I studied in connection with my business, like all the rest of it, in El Paso, in Houston and New York. And I usually take this stuff along with me in the plane. It

is a very nice way to be undisturbed and to read and study the figures. I mean just what I am saying.

Q. Well now, aside from the reasons you have given us, is there some reason why these economies with reference to personnel could not be accomplished with a subsidiary? A. The ones that we have just been talking about, represented by the study of Mr. Steen, cannot be accomplished by separate corporate organization operation.

Q. And what is the reason for that?

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A. Inherent in it. Inherent in the separate operation.

Q. Could you spell that out a little more? A. Well, the company is now, and at the time we acquired the stock, being operated with those various departments fully staffed —not fully staffed, but they have been building them up— and if they are to operate as a separate corporation and perform the functions that they are supposed to perform, and render the service to the public that they are certificated to render, they have to have those departments fully staffed. So that if they operate as a separate corporation, they must incur those costs.

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Cross-Examination

By Mr. Kirsch:

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I would like to say this, too, that the fact we have reversed the flow, or plan to reverse the flow in the Colorado Interstate line makes those reserves that we are developing in Wyoming much more readily available to the El Paso

system, and therefore we have a larger incentive to explore in Wyoming.

Q. You stated that this merger would stimulate the exploration and development of the Rocky Mountain area. Would you elaborate on that, as far as Wyoming producers are concerned? A. Yes. By reason of the fact that we would have the actual ownership of the pipeline running through the Rocky Mountain area and have the connection with the Colorado Interstate that we propose to make, it makes practically all of that producing area, potential producing area, tributary to our system. And we would explore for it just as diligently and actively as we would for that in the San Juan Basin, or

in Lea County, New Mexico, or in Texas.

Q. It was earlier stated that there are more reserves in the Big Piney area than Pacific Northwest has market for. How would this proposed merger affect the producers in just the Big Piney field? A. Well, it will give them the immediate connection to the California market, and the California market is developing—I would not want to say more rapidly than any other market, but it is certainly developing very rapidly, and the connection to that market will benefit the producers, giving them an immediate market for the gas that they drill up. And that is an important thing, because a producer, when he discovers a given gas reserve, he is not willing to drill it up unless he can see where he can market it. He cannot afford to. So the presence of a pipeline within economic reach has a very stimulating effect upon the development of the reserves as well as the discovery of them.

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By Mr. Bennett:

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Q. Now, you stated that in the summer of 1956 you acquired knowledge of the fact that Pacific Northwest was endeavoring to enter the California market, is that correct?

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A. Yes.

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Q. And were you concerned when you acquired knowledge of the fact that the Pacific Northwest Company was endeavoring to make arrangements to sell gas to the Pacific Gas & Electric Company? A. Not too much in respect to them.

Q. Well, did you welcome that possible competition? A. We did not regard it so much as competition, Mr. Bennett. We were directly negotiating, ourselves, and we were not having much luck with the—

Presiding Examiner: With whom, P.G. & E.?

The Witness: With P.G. & E. for the reasons that we explained. They were very much interested and absorbed in their project to bring gas from Canada.

By Mr. Bennett:

Q. Well, were you concerned about the possibility that Pacific Northwest system might sell to one or all of the

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Southern companies? A. No, we were not.

Q. You gave it no thought or concern whatsoever, is that what you are saying? A. I say that. It just never seemed to me that there was any chance for them to make any contract with them. I felt that if they joined with us

we might be able to make a proposition, just like we had worked out the Mountain Home transaction.

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By Mr. Bennett:

Q. —of Volume I of the transcript, you began to talk about residue gas, and you went on to tell us what the Texas Commission did with reference to shutdown. Now, is the situation of your company with residue gas—did that have some influence upon your determination to acquire the Pacific Northwest system? A. Yes, it did.

Q. And in what regard? A. Because we find ourselves, and I say that advisedly, marketing about a billion three to a billion and a half feet of residue gas a day, which is right at one-half of our total supply. And we worked up to the fact that on one occasion we had to supply, I believe it was, some 800 million feet of dry gas on short notice by reason of the vagaries and falling off from various reasons of residue gas. So that we found that in our eagerness to get gas and get it to market, we had gotten our company topheavy with the quantity of residue gas that was marketed, and that we felt that we would have to decline to take any more residue gas unless we could make proper provision for larger quantities of dry gas to go along with it so as to be able to meet the emergencies that were created by the falling off of the supply

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of residue gas due to proration. For that reason we wanted to connect our system to the Rocky Mountain areas where the gas is overwhelmingly dry gas, and to the Canadian market where it is likewise true.

Q. Well, you are still acquiring residue gas, are you not? A. Yes, we are.

Q. Is this magnifying your problem then, these additional

acquisitions? A. Oh, we are trying to keep a balance so that we do not get any worse off than we are, and we are trying to improve our position percentagewise. And I think we are.

Q. Now with reference to your bond structure, is it your testimony that because of the residue gas situation picture concerning El Paso, that it is because of that that your company has the highest amortization rate of all pipeline companies with reference to its bonds? A. Yes, I think that is the underlying cause. The mathematical cause is that when we set up our gas reserves and make, and have made by independent geologists, the reports of our gas reserves to the people who buy our securities, we show a total life of around 15 to 18 years, whereas I think the industry generally shows nearly 20 years.

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Q. Mr. Kayser, on page 88 of your direct testimony, line 7 thereof, you stated that it will reduce the amount of capital cost that it takes to connect those reserves into the market. What did you mean by capital cost in that respect? A. I mean this, that while the gas from Big Piney may not flow actually, physically, to California, the fact that that supply moves into the pipeline from that point into the Pacific Northwest pipeline makes available whatever amount it is to the California market and all the other markets of the company.

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Q. Now, are you suggesting that there would be a duplication of cost in this regard if the Pacific Northwest system were not merged with El Paso? A. Not in every instance, but from the standpoint of making the reserves of that entire region available as a source of supply to all of the customers of both systems, what I say is correct. In

other words, if El Paso wanted to get reserves out of the Big Piney area, or any other place in the Rocky Mountain area, independently of Pacific Northwest, or from Canada, they would have to build a pipeline for that purpose. Whereas, with the two, or, one system, then looping can be done, small branch lines built out to the supply, the new discoveries, and connected into the entire system at once. It is simply an incident to a system that has its lines running fairly adjacent to the points of production.

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Q. And you also testified that unless the Federal Power Commission approves this merger, or applied for merger,

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that El Paso will divest itself of the Pacific Northwest stock; is that correct? A. I think that is a conclusion that we cannot escape, as little as I like it.

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But also we had already found out that in any attempt to operate it as a separate company with separate preferred stock outstanding and with separate bonds outstanding, and with a separate set of customers, presented a lot of difficulties, and we were trying to solve them. We met them at the first meeting that we had to put together the operation in the field, and it was serious. But I am not saying that if we had not been challenged we would not have gone on for a substantial length of time. It was my judgment in the beginning, it was the way we wanted to do it, that the simple way to do it is to join the two properties together physically and operate them as one company—and could best serve the public doing it. But I am not saying we would not have gone forward and we would not have done fairly well.

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Q. Now, Mr. Kayser, you testified previously about the availability of the Big Piney reserves to the Market of El Paso, and at page 91, line 18, about the possibility of a cut-off for a day or two.

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With reference to this testimony, did you have in mind that Pacific Northwest and El Paso would be independent of each other? A. No, this testimony, I believe, on page 91 is related to the merged system, how it could be operated with flexibility for the service of all of the customers.

Q. Well, would the flexibility be any less if El Paso continued to control Pacific as it does today? A. It would be less. Now, let me explain that. I do not want to just be saying that and sound like it is arbitrary. But the fact is this—

Q. Pardon me one moment. Could you also define "flexibility" for us as you are using it? A. Yes. That as we use it there means the capacity in the line as built and operated to make deliveries in varying quantities at the various spots where it may be needed, and particularly in relation to a shortage in any given source of supply. That is about as good a definition as I know how to make. Flexibility of operation about which we are talking there.

Now, even like it is today—now, I am not criticizing any of the gentlemen who are here operating Pacific Northwest, but human nature is human nature, and if you are runnnig your job, that corporation, that property, and El Paso call up and says "We are short and we want 100 million feet of gas"—

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oh, yes, I have the authority, I can call them on the phone and say "Now, get it over there". But that is not the

way it works. It works between the lower echelons. And you do not have that immediate flexibility that you would have under a single control. Now, that is just a fact of human nature and physical operation. I do not say that you cannot attain a substantial measure of flexibility, but you cannot attain it with that perfection that you can through a single ownership.

Q. And that is what you had in mind when you said there would be, or meant there would be, less flexibility, is that it? A. Yes, there would be less flexibility if there was a separate corporation operating those properties and a separate corporation operating the El Paso properties.

Q. Now, could not you take care of that by the device of circularizing through the entire system, that is both systems, a memorandum in rather specific terms telling them to cooperate? Would not that be a simple— A. Oh, yes.

Q. That would be a rather simple thing to do, wouldn't it? A. Yes. But—

Q. From the office of the Chairman couldn't that be done? A. Well, let's say this, that it never has been done—

not with me.

Q. But it could be done, couldn't it? A. I do not think it could be done effectively. But I do not want to argue about that, but I would like to say this: Let me just make this distinction now. Mr. Bennett, you are assuming that we continue to own the 100 per cent of the stock. Now, I am not going to tell you that if we own 100 per cent of the stock, or 99.8, I am not telling you we cannot work out a good deal of flexibility. I am not saying that. I am saying it never would be as perfect. But we can work it out, do not bother about that. But I am telling you that after this proceeding breaks up, if it has to be a separate

corporation, we cannot continue to own it, we will not have any say-so as to whether they let us have the 100 million feet of gas or not.

Q. But assuming you continue to own it, I presume that you as President of El Paso, and from your position on the Pacific Northwest Board, could require your employees to obey your wishes, could you not? A. Oh yes. And we can get out a measure, a very substantial measure, of flexibility—do not bother about that—if we continue to own the stock. But not as perfect as you can with the single operation.

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Q. Now, under the merger proposal, or plan, is the cost of this additional gas—that is, the 28-cent gas—as against the 22-cent gas, to be kept separate? A. We have not contemplated to date anything different from the normal accounting practices of the Federal Power Commission.

Q. You mean, then, it would be a rolled-in cost? A. Well, whatever the Commission says, that is what it will be.

Q. What do you intend to do, without reference to the Commission, if you can conceive of that? You will do it first and then come here for approval, I gather, will you not? A. Well, we will keep our accounts in accordance with the regulations. We have already stated in the record very carefully what we consider to be the correct handling of the cost.

Q. What is that? A. I am willing to state it in broad lines, but I do not want what I say now to be interpreted as limiting anything I said before. But I would like to say that the principle involved, as we see it, is that the customers of Pacific Northwest now present customers of that property, should be their proper share of the cost of that pipeline as it has been constructed. And as I mentioned yesterday, the Commission saw

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fit, and I think properly, that a domestic supply should have been made available to those Northwest markets.

Obviously, the cost of doing that should be properly distributed among those people who get advantages from the construction of that property.

Presiding Examiner: That is the pipeline from the San Juan Basin to the Pacific Northwest?

The Witness: Right.

By Mr. Bennett:

Q. Now, Mr. Kayser, the 28-cent gas is going to raise your average price, is it not? A. It cannot help it.

Q. Well, are you going to charge, then, an average cost to the customers, or how are you going to handle that, specifically? A. Well, I am not prepared, Mr. Bennett—I just cannot be—to try a rate case this morning. That is quite a difficult thing. I can only state the principles of policy that I think out to be applied. The ultimate decision will be on the Commission.

The exact handling of each account I would not undertake to try to pass on this morning.

Mr. Bennett: Mr. Examiner, I think the question is rather clear, and I am going to ask that you instruct the witness to answer, if he understands it.

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Mr. Shannon: I submit he has already answered the question, Mr. Examiner.

Presiding Examiner: Let us have the question read, and let us see just what the question is.

(The question, as recorded, was read by the reporter.)

Presiding Examiner: Is the El Paso Company going to have complete control, then, or as a regulated utility will

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it not have to come to the Commission to find out what it is going to do? It seems to me that is what it will have to do, and I think that was the substance of his reply.

Mr. Kurtz: You mean by that that El Paso does not know what they are going to do, and anything that the Commission suggests is agreeable to El Paso?

Presiding Examiner: I do not mean that; no, sir.

Mr. Kurtz: I just wanted to know—

Presiding Examiner: There will be a battle, I predict it now, but the battle is what I am talking about, and the Commission will come out the victor because it has the power.

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Mr. Bennett: Mr. Examiner, I think the question is quite proper. I think it relates to what was said upon direct examination concerning the vast benefits to the entire West so far as this merger is involved. There was no hesitancy in telling us about the benefits. We simply want to know who is going to pay the cost of this. Now, surely if El Paso is so positive concerning the existence of benefits, they must have some notion of how these benefits are going to be paid for, by whom, what states as against other states.

Presiding Examiner: There are presently in effect rates, the tariffs are on file with the Federal Power Commission, and the consumers are paying those rates. Unless those rates are changed, no one will be affected by the 28-cent purchase at the border. And who is going to pay that, and how it is going to be divided, is going to have to be determined in some later rate case when there is a revision of rates.

Am I wrong about that?

Mr. Kurtz: Mr Examiner—

Mr. Bennett: Mr. Examiner, I must say this in that regard. This is a prospective case. Now, just as they can look into the future and predict benefits, we are en-

titled to look into the future and predict certain disabilities arising from this. And while we can not specifically state what the Commission will do with reference to a rate picture in the future, I think at the very least we are entitled to know how the specific

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figures are proposed to be treated regardless of whether or not the Commission approves or disapproves because the beginning of this thing must be El Paso's treatment, whether approved subsequently or not. At least let us find out that, and we will take our chances upon what the Commission might do in the future.

Mr. Kurtz: I rose, Mr. Examiner,—I am sure Mr. Bennett and I might be entirely at odds in this particular point. But what we are concerned here with is the effect upon the consumer, and one of those effects is what he pays for the gas.

Presiding Examiner: Oh, yes.

Mr. Kurtz: Now, it is true that they have rates on file, and those rates will be changed as they go down through time. But what we are now concerned with in a merger is what is the effect upon that consumer, amongst other things. And the only thing that we can do is to look to the future and see what those costs are going to be to that consumer.

Presiding Examiner: That is right, but—

Mr. Kurtz: The costs I am talking about. And I think we have used this term "rates" and "costs" interchangeably, but there is entirely—do not think we are here trying to say that El Paso has to charge a certain rate, but we are here, and one of the issues is what those costs are going to be to the consumer as projected.

Presiding Examiner: Yes, but Mr. Bennett's question is

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which consumer, as I understand it. Am I wrong about that? Which consumer is going to bear that cost?

Mr. Kurtz: And which consumer bears the cost, whether it is the California companies or the Pacific Northwest Company, is important.

Presiding Examiner: I agree with you that it is important, but how is it going to be determined except in a rate case is all I know.

Mr. Kurtz: Right from these figures they already have in the record. That is what these are all about, the economic studies they put in here. El Paso itself can make that determination—

Presiding Examiner: As to the breakdown, as to the 28-cent rate, at this moment they are going to say which consumers are going to pay that 28-cent rate?

Mr. Kurtz: They do not change the rate structure as such, but the costs are already in this record.

Presiding Examiner: And will go into a rate structure at the proper time.

Mr. Kurtz: How are you going to determine which customers benefit? Frankly, on this matter, if you are going to separate out these companies and put them together, they are not the same as if they were two wholly independent companies. And what is the effect of that going to be on cost to the consumer? I think that is very vital.

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Presiding Examiner: I do, too, Mr. Kurtz, but how are you going to handle it? How are you going to handle it for this record?

Mr. Kurtz: Going to handle what?

Presiding Examiner: How are we going to make a determination of which consumers, how are we going to

know which consumers, are going to bear it until the Commission so determines?

Mr. Bennett: Mr. Examiner, I did not ask which customer is going to bear it. If you look at the record, I did not ask if California was going to pay for this. I asked how he was going to treat it accountingwise, rolled in, or what method. You can draw your own conclusion as to who is going to pay for it after that.

Mr. Kurtz: Let me point out something to you here, Mr. Examiner. I get unduly alarmed at times of getting into a rate case. I know what they are. In fact, it was just called to my attention already in this record we have the very problem presented by the El Paso Company, Mr. Dunn's allocation study. There are no rates filed for it, but it does allocate to the various customers gas costs put in by El Paso. And it is also required by the Commission's rules.

The Witness: I am willing to answer the question.

Presiding Examiner: That takes the pressure off me, if your counsel will go along with you.

Mr. Kurtz: I am willing to say this, Mr. Bennett.

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By Mr. Bennett:

Q. Mr. Kayser, before you answer the question, do you have in mind the specific question to which I am asking for a responsive answer? A. That is right. You are asking whether or not the 28-cent gas price, how it is going to be handled, is that it specifically?

Q. I asked you whether it was going to be treated on an average cost basis, or whatever? A. Well, I think that the figures that the accountants, and those who are making the figures—I think that they have treated the cost as an average cost for all gas throughout the entire system. Now I am answering that factually, as to what is now in the record.

You have asked me, though, I understood you to ask me, from the standpoint of principle, is that what the company will insist upon. Now I am willing to answer that; at the moment I am not clear whether that will be just or not. And I, in my own thinking, it may not prevail at all, but we always try to study the relationship between our customers and take a position in that conflict that we think is right. After all, the Commission is the arbiter and has to decide them.

Now I think that the principle that should guide the Commission is that the ones, the customer, who is to benefit

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by the importation of that gas is to share in that cost to the extent of the benefits. Now that is quite a job, to find out what that is. But I am telling you that is the principle that we think ought to be used.

Q. Well are you saying now that you can not tell who is going to get the benefits from this gas, that is the consumers? A. I am saying that I will try to see as far as we can that the one who pays for it, who gets the benefit, pays in proportion to his benefit.

Q. Well now you have already testified that this Canadian gas would benefit all of the consumers— A. That is right.

Q. —of the combined system? A. That is exactly correct, too, and that should be taken into consideration. But I did not say that the benefits would be equal to all. You see, there is a distinction.

Q. You mean that one group of consumers is going to get greater benefits than others? A. Sure, I think that is undoubtedly correct.

Q. Tell us which consumers then are going to get—well, for example, is California going to get more benefits than the Pacific Northwest consumers or less? A. I told you I could not specify that at the moment, Mr. Bennett, for the reason that when you talk about benefits

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from an accretion, or an increase of your gas supply, you are talking about a very complicated matter of allocation. Now I do not think you have to be bound by the exact third grade arithmetic that comes out with an answer, I do not think you can do it that way.

But I also want to call attention to this, that the factors that determine the relative benefits will not remain exactly the same. And I want to show you what I mean by that. I do not want to be arbitrary, and I want you to understand it. It is important—

Q. Mr. Kayser— A. Let me finish.

Mr. Shannon: Let him finish his answer.

Mr. Bennett: I am sorry.

The Witness: Watch, now, we are only bringing in at the moment 200-odd million. Now that is actually being consumed right around the place were it comes into the United States. Now then we are proposing to bring this 150 in. Now that mostly is going to be consumed there. But I envision this thing, that there will be brought in through those gateways as the years go on, in the range—and this is not fantastic at all—of one billion feet of gas a day. And I can easily envision that there will be a pipeline from the border, looping practically all the way down to the Las Vegas entry. Now I am saying that based upon the experience that we have

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had, because there is over a billion a day now certificated to go through the two gateways of Topock and Blythe. Now as that thing changes, and the gas is brought down and delivered directly to the California border for consumption in Californaia, the relative benefits of the importation of Canadian gas will change. And I think all of that should be taken into consideration.

(1560)

By Mr. Bennett:

Q. Well now, Mr. Kayser, are you going to determine who is the recipient of the greater benefits as among the western states? A. I am going to have an idea about it, as you asked me to have a while ago, and I am willing to say that the principle, that I think that the company—I am talking about the company and not myself—the principle that the company should be guided by is to just use its best judgment as to who has the greatest benefit, and therefore who should pay. The one who says is the one who is sitting over here on my left.

Q. You will make a determination, that is, El Paso will, as to which state is getting the benefits and the price will follow accordingly, is that correct? A. No. No—

Q. Subject to Federal Power Commission approval, of course?

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A. No, it is not that simple.

Q. Well, what is your plan? I thought that is what you just said? A. Well, it is to do what I said in relation to the principles involved, and it comes up, as has been properly stated—it can come up for some measure of discussion of principles in a certificate case. And the Commission can even, of course, as we know, put a price limitation on it if they want to, and all of that. But your real determination will come in a thorough-going rate case involving all of the rates of the system, as that frequently happens, and in that case your allocation studies will be made and, as I say, our position about it will be that we will study it ourselves and endeavor to arrive at what we think is a proper relationship between the states.

Presiding Examiner: Suppose we take the morning recess at this moment.

(At this point, 11:20 a.m., a recess was taken until 11:30 a.m.)

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Presiding Examiner: Let's proceed, gentlemen. Proceed with your cross-examination, Mr. Bennett.

By Mr. Bennett:

Q. Mr. Kayser, you testified on your direct examination and also on amplification thereon and on cross-examination of the numerous benefits to consumers because of this proposed merger. Isn't that so? A. That is right.

Q. Now, as part of those benefits, did you determine how the El Paso Natural Gas Company was going to treat this 28 cent gas coming in from Canada? A. No.

Q. As to cost to customers on the system? A. No, we did not.

Q. Well, then, the benefits, at least, as to the price of this gas, as it is supplied to consumers, as to price benefits—you don't know what they would be, then, do you? A. Except that we would expect to determine it at the proper time in relation to the principles that I stated just before the recess.

Q. Not having made a study of that, you are not in a position to say at this time whether California will bear the cost of that 28 cent gas entirely, or whether the Pacific Northwest States will bear it, or just how it will be allocated?

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A. Well, under the principles that I have stated, it will be allocated between those who got the benefits, and I haven't changed about that at all. I think that is the only way.

Q. We agreed that that is somewhat of a vague concept that has to be worked out in detail to mean anything, isn't it? A. Well, it isn't so vague. It's like all principles, broad enough to cover the thing, then you have to work out the details.

(1563)

Q. It is a pretty general thing. Right now, it doesn't mean much, does it? A. Oh, it means a lot to me.

Q. I mean in terms of actual cost, it doesn't mean anything. A. It doesn't? It does to me.

Q. Tell me what the costs will be, then. A. I can't give you—obviously, I can't give it to you in terms of cents.

Q. Then at this point, it is nothing more than a pleasant generality? A. Oh, I wouldn't characterize it that way at all.

Q. Could you tell us what you are going to charge California customers, for example? A. You mean on this new—

(1564)

Q. On the 28 cent gas? A. Well, we have already proposed for in the application—it is in this record, I think; I think it was introduced, the 470 case and the price. I testified about it, the price for the Las Vegas entry is 40 cents.

Q. Does that involve— A. I think that fairly well distributes the benefits. Now, I don't know. I haven't had time to study it with the accuracy that we would, of course, at a later time. But what we are trying to do is do it on a fair basis.

Q. Does that price at Las Vegas include the 150 million Canadian gas at 28 cents? A. I think our contract does, yes. I think that is right. I'll take a look at the contract, but I'm quite sure that it does.

Now, the application doesn't cover the 150.

Q. You can't tell us at this time, then, specifically how you propose to treat this 28 cent gas as against the 22 cent gas in terms of a price to your customers, can you? Specifically, now? A. No, I can't tell you exactly the allocation that should be made of those prices. I sure can't.

Q. Well, now, is it still your position that the present customers of the Pacific Northwest system should bear the costs of that system as it exists today?

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A. They should certainly do that.

Presiding Examiner: That is the pipeline system you are talking about?

Mr. Bennett: Yes, sir.

The Witness: Yes, and as the expansion and additional sales are made, the participation in costs should be spread among those who benefit by the sale.

By Mr. Bennett:

Q. But the costs of expansion and sales, as those sales lead into the customers of the Pacific Northwest system, those costs in the future are to be borne by the Pacific Northwest system customers, is that correct? A. No, that isn't quite the way the Commission does it. I think that as I said, in respect to the importation of Canadian gas, in any allocation scheme or studies, due consideration should be given to the one that is bringing about the importation.

Q. Well, then, the California consumers would then pay some of those costs, is that right? A. They should, by all means. There is no question about that.

Q. Is there any escalation clause in that contract relating to the 150 million price escalation clause? A. No, that price is based upon the cost of service—now, wait a minute. I don't want to say that too fast.

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I believe that there is an escalation in the price of the gas that was purchased by Pacific Northwest to service that contract. Consequently, the cost of service of that contract would be affected by a contractual increase in the cost of gas.

Q. Then the 28 cent contract price is not a fixed price, as is the Sumas contract price? A. No, that is absolutely correct.

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Q. Mr. Kayser, on page 95 of the reporter's transcript, line 13 thereof, you stated that our policy was to serve every community within economic reach of our line. A. Yes, sir.

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Q. Now, you said the present financial condition of Pacific Northwest is not satisfactory, and it showed a loss of $2,067,000 in 1957? A. That is correct.

Q. Is it any more satisfactory today? A. It is a little bit, and it looks like it is improving.

Q. You expect it to show a loss again, however? A. In '58?

Q. Yes, sir.

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Q. Has the acquisition of Pacific Northwest's stock by El Paso strengthened El Paso's financial position? A. El Paso's financial position?

Q. Yes, sir.

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A. Only in a long range view, because I think that the financial community considered that when we acquired that stock and made the application for merger, the thing would be merged and the system would be a stronger system after the merger than it was before.

Q. Well, actually, the acquisition of the stock detracted from your financial position, did it not? A. No, I'm talking about the long run financial position, and not just your balance sheet.

Q. Well, let's talk about immediately, then. Ignore for the moment the long range viewpoint. Immediately, it detracted from El Paso's financial position, did it not?

A. Let's make the distinction, because I carry the distinctions in my mind this way: The mathematical immediate effect and the long range effect on the appraisal of the company by the investors and lending agencies—banks and insurance companies and so forth. Now, the position of El Paso Company was strengthened in the latter category. I have not examined what exactly the dollar position—what effect the acquisitions had on the dollar position. I just don't remember it at the moment. I would have to study the balance sheets and the various items before and after taking.

Q. What is the dividend requirement of the El Paso Natural Gas Company? A. $1.30 a share.

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Q. How many shares of common stock did El Paso issue to acquire the Pacific Northwest Corporation? Or was it approximately 5,226,903? A. I was going to say approximately five million.

Q. Then strike approximately. A. That sounds exactly right to me.

Q. Now, on each of those five million and more shares which I have referred to, there likewise is a dividend requirement of a dollar thirty cents, isn't that so? A. That is right, beginning with the year 1958.

Q. And that means, does it not, that if you multiply $1.30 times the five million and more shares I have referred to, you will arrive at a figure of $6,794,974, if you will accept that? A. That is correct, I'm sure.

Q. What are those shares issued to acquire the Pacific Northwest system earning so far as Pacific's system is concerned? What is Pacific contributing now toward those shares issued to acquire it? A. Well, so far as income is concerned, they did not contribute to the income. But the tax saving, tax losses, is worth substantial money.

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Q. Do you think 1959 will be another loss year? A. I think that is true from an operational standpoint. But let me make this tax thing clear. Obviously, the consolidated system, the increment calculated, based upon the total deductions for the consolidated system. But the previous loss carryover accumulated by Pacific Northwest in the amount of $23,000,000 cannot be taken by El Paso by consolidating the two companies under the consolidation provision of the Internal Revenue Act. But upon the merger of the two companies, that loss carryover can be taken and if the merger should be effected in 1959, then we would get the benefit of a large tax deduction, which would be just worth that much to us, income-wise, to the common stock holders.

If I may make one further statement.

Q. Certainly. A. Speaking about the effect on El Paso financially, I think if you will look at the stock, the market for the common stock, you will find that it has been uniformly strong since the acquisition of the stock became apparent, and also likewise even after the filing of the Justice Department's suit, succeeded by the filing of this merger. The stock has

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been strong, which represents an appraisal of the financial position of the combined properties.

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Q. Well, from what you know now, isn't a rate increase, so far as the Pacific Northwest system's customers are concerned necessary? A. We have covered that, I think. Well, I know we have; I have, carefully, and that is to this effect, that when we put into effect the plan that is

covered by what we call our 470 million case, that will very substantially improve the earning power of Pacific Northwest.

Now, in addition to that, I have already testified that we have checked on and contemplate a number of extensions of the Pacific Northwest properties if we acquire them, and there, too, we can expect an improvement in Pacific Northwest's earnings.

In addition, I believe that we can bring about a substantial increase; I think there is going to be a substantial increase in the business that is already attached. You put all of those things together, and it may not be necessary to increase the rates at all, but I'm willing to stick my neck out on this, that I don't think that the increase will be radical. It may be. I have also said that it will be our policy not to file any application for rate increase in respect to those properties until we have operated them for a year and found out what were the potentialities.

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Q. Mr. Kayser, when you state that there will be no application for a rate increase for a year, what is the beginning date of that year you speak about? A. I would like to make it yesterday, but I think that it will kind of have to be from the time the merger is granted. Then we can really move in and find out what savings we can actually make immediately, and have an understanding of what we hope to do in the future. It is a costly thing to do, but I think in the long run, it will pay dividends.

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Q. Keeping in mind, Mr. Kayser, that Arizona will double its population between 1950 and 1960, and because of the extensive population growth in Arizona, is this merger

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going to in any way diminish the ability of El Paso Natural Gas to serve Arizona, based upon what they anticipate as a large increase of population? A. No, sir. On the contrary, it will strengthen the company's ability to serve Arizona and will, in my judgment, unquestionably lengthen the total life of effective, abundant

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gas service to Arizona.

Q. May I also ask whether in your opinion this merger, would it cause an increase of rate—I am not thinking now in the terms of normal increases that the El Paso Company would have because of price increases, but would the merger of itself cause any increase in rate? A. No, it just does not.

Q. You do not anticipate any? A. No, it does not, it has no element in it that would increase the cost of service to the Arizona customers.

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Q. Now you stated that you knew that in the fall of 1956 the Pacific Northwest system had made an offer to sell Canadian gas to the Pacific Gas and Electric Company; is that correct? A. In August 19—?

Q. In the fall of 1956? A. 1956? Yes, I knew it.

Q. How did you acquire that knowledge? A. Well, I can not remember exactly how I acquired it. It is not unlikely that I acquired it directly from Pacific Gas and Electric Company, or that I acquired it directly from Pacific Northwest Pipeline Corporation. And I do not remember which. Probably both.

Q. And you also knew in the fall of 1956 that the

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Edison Company was negotiating, or had signed a contract, with Pacific Northwest, did you not? A. No, in the fall that was all over.

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Q. And did you have a meeting with him in 1956? A. Yes, sir.

Q. And this was after Edison and Pacific Northwest had signed its contract, was it? A. It was around in the first part—yes, in the first part of August.

Q. And where did you meet with Mr. Quinton? A. In his office in Los Angeles.

Q. And how long was that meeting?

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A. I do not know.

Q. Well, was it a short or a long meeting? A. I do not know. Sufficient for us to do what we did.

Q. What were you talking about generally? A. We were talking about gas supply.

Q. Did you discuss this Edison-Pacific Northwest contract with Mr. Quinton? A. I can not remember clearly whether I discussed it with him in the first meeting or not. I might have and I might not.

Q. Was this the first meeting then? A. Yes, this was the first meeting with Mr. Quinton.

Q. Didn't you express some concern about the entry of Pacific into the California markets to Mr. Quinton at that time? A. No, I did not. I was not concerned about that. I was first concerned about satisfying his demands.

Q. Well did you talk about his contract with Pacific Northwest system? A. I probably did. Now the only thing that is a little hazy in my mind, Mr. Bennett, is whether or not at that particular conference I knew of the contract. Now I knew of the negotiation, but whether

I knew about the contract or not then—I do not know whether I did or not.

Q. Well do you recall whether Mr. Quinton told you he had a contract with Pacific—

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A. I do not recall whether he did in that first meeting or not. But I certainly know that before too long I knew about it and talked to him about it very thoroughly.

Q. Well now, in talking about it to him very thoroughly, what did you say about that contract? Did you ask him to do anything about it at all? A. No, the only thing that I remember very clearly is that I said to him that "I want to know if you want to try to trade with me, and if you are bound otherwise, I do not even want to ask you to trade with me". Because I have—

Q. At that first or second meeting then— A. Well, whichever one it was where I knew of the negotiation. And I am not absolutely clear as to whether it was at that first meeting or not, and I do not want to pinpoint it quite that much. But at some point, and after I had learned of the existence of an agreement signed between them—and I never seen it—I told him frankly, which is the only thing to do when you are trading, is to determine whether or not the man you are trying to trade with is free to trade. And I will say this, that as far as I know, I do not remember ever having asked a man to get out of his contract. I have said to him over and over again, "Now I do not even want to negotiate with you seriously until you tell me you want to trade, you are free to trade". Now that is not moral consideration, that is for business consideration. Because when

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a man is tied, he can fish around and get a lot of information out of you that is of no help to you, and may be a lot

of help to him and may put him in a position to retrade, or trade better than the other fellow. And that is one of the things I try to do, everyone tries to do. You want a man to be free.

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Q. Did Mr. Quinton tell you he was free to talk to you then? A. When he got down to trading he did not mince words at all. He said he was—"I am ready to talk business with you".

Q. Was that at the first meeting? A. That is what I say I cannot tell you now. I do not believe it was at the first meeting. I am not—I just cannot tell you, cannot pinpoint the time when he said that, and I do not want to do it.

But before we did get down to real trading, he did just that.

Q. Mr. Kayser, you did express some concern about Pacific's possible entry into the California market, didn't you, to Mr. Quinton? A. I did not express it that way, Mr. Bennett. I expressed always to Mr. Quinton, without any sort of questions, so far as I am concerned, that I was deeply concerned about a split between him and his supplier, the Southern California Gas Company. And I told him that that was a serious thing, and that any breaking off on his part would be a disrupting thing, and that I wanted to do my best to try to avoid that disruption.

Q. Well, didn't you tell him that you would do something with reference to Pacific Northwest in its effort to

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come into the California market. A. I probably told him that I regarded it as against the public interest for him to buy his gas supply against the interest of Southern California Gas Company, and that I was opposed to any such purchase.

Q. You told him you were opposed to any purchase from Pacific Northwest, then? A. Well, I would not want to say that I said Pacific Northwest, but I told him any purchase—that was not all he had been talking about.

Q. Was there any other contract at that time— A. There were other propositions floating in there like leaves on an autumn day.

Q. From Canadian sources? A. I would not want to say Canadian sources for sure. I do not remember—

Q. What other sources, then? A. From the Gulf.

Q. Gulf? A. Right, and from Mexico.

Q. What companies by name? A. There was a group headed by a Mr. Hargrove. I think that is right. He was continuously working at the proposition. There was another group, but I forget the name of the person who headed it up. There was a group that was headed by some

prominent people in Los Angeles, whose names escape me, who were negotiating for the Mexican gas, bringing it up around through Mexico up to a point opposite California.

Q. And you told him that these things, in your opinion, would not be in the public interest? A. That is right. I told him that for him to buy his gas separately and discontinue his cooperation and his relationship as a customer of the Southern California Gas Company I considered to be against the public interest.

Q. What was his reply to that? A. Well, he did not agree to it, but—I mean, in words, but he came ahead and contracted with me. That is, we traded, ultimately.

Q. In other words, was it then your concept of the public interest that Southern Company should continue to take all of its gas from El Paso? A. No. No, that was not what I was talking to him about.

Q. What was it at that time that caused you to say the contract between Southern California Edison and Pacific

Northwest was not in the public interest? A. I did not say that.

Q. Well, what was it you meant, then, by saying or referring to public interest? A. I said that it was not in the public interest for

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him to buy his gas on a direct purchase outside and bring it in to the detriment of the business of the Southern California Gas Companies.

Q. When you referred to public interest at that time, did you also have in mind El Paso's interest, or was it entirely just the public interest? A. I had in mind both.

Q. You were out there representing the public interest and El Paso's interest? A. We tried to. And in some instances, we have done a pretty good job.

Q. Well now, Mr. Kayser, did you not say something else to Mr. Quinton about what you would do with reference to Pacific Northwest and its activities, with regard to coming into the California market? A. I do not remember anything different from what I have said.

Q. Well, didn't you tell him you would do something about that situation? A. I said a while ago what I said I told him. I told him I would oppose any purchase by him that did not take into account the Southern California Gas Companies, Southern Counties Gas Companies situation in respect to him as their customer.

Q. You also told him you would oppose Pacific

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Northwest, didn't you? A. I cannot say that I said that.

Q. Well, would you mind thinking very hard about that and recalling whether you said it or did not? A. Well, I do not remember saying it.

Q. Well, it is possible you might have, however? A. Oh, I could have said it, sure.

Q. And as a matter of fact, you told him you would go

(1614)

to any lengths to keep Pacific out of the California market, did you not? A. I did not.

Q. Are you quite sure about that? A. Yes; I did not say that.

Q. Do you want to think about that a little bit? A. No, I do not want to think about it.

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Q. Did you ever talk to the officials of the Pacific Lighting Company concerning Mr. Quinton's proposal to buy gas from the Pacific Northwest system prior to your first meeting with Mr. Quinton? A. I am not sure about that. That is the same thing that I am not clear about as to the conversation in the first meeting. But prior to the second meeting I certainly talked to the executives of Pacific Lighting Corporation about the whole situation.

Q. Well now at this meeting with Mr. Quinton, were you interceding on behalf of Pacific Lighting with Mr. Quinton then? A. I went to see Mr. Quinton initially, after having had very thorough discussions with the executives of the Southern California gas companies, Southern Counties Gas Company, in respect to the break that seemed imminent and serious to me between the Southern California Edison Company and the Southern California gas companies. And that break had been developing since March of that year.

Q. Would you tell us now why it was against the public interest for the Southern California Edison Company to make a contract with the Pacific Northwest system to bring more gas into California? A. Because if you study the history of the utility regulation, utility service, you will find that there is a

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well-established principle in respect to gas, and it has somewhat the same connotations in respect to electricity, but certainly as to gas, that the large users who have a

choice of fuel should be attached by the distributor, and the price that they should sell the commodity to that large user who has a choice—some of the decisions go so far as to say the price should be all the traffic will bear so as to come up even with the cost of the other fuel, giving a little incentive for it. But I do not quite go that far. But I do go this far, that if you strip the big users from any distribution company, and I do not care where it is, you will raise the price to the domestic user, and the commercial user. And on that basis, I consider it to be against the public interest, and against our own specific financial interests, because when you take those customers away from our company, I mean, our distributor, our distributor will be unable to take his fuel allotment of gas from us.

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Q. You are going to bring down Canadian gas now, aren't you? Isn't that one of the benefits you are talking about? A. I am going to bring down Canadian gas, yes.

Q. Why is it a benefit when you do it, but against the public interest when Edison-Pacific Northwest wanted to do it? A. For the reasons I gave a moment ago.

Q. In other words, because you keep the customer it is a benefit, and when you didn't it becomes against the public interest? Isn't that what it amounts to? A. No, that is not correct. I have not opposed Trans-Western making a contract with Southern California gas companies.

Q. Has that hearing been commenced yet, the Trans-Western hearing? A. It starts here the 15th day of December.

Q. Well the hearing has not even begun, has it? A. Yes, but I am telling you that we are not opposing it. And we are not.

Q. Has there been opportunity to oppose it yet before this Commission? A. Oh, my gosh, certainly, yes.

(1617)

Q. There has been a hearing on this Trans-Western matter. A. I say, there is opportunity to oppose it, there has

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been and is existing at this moment, and we are not opposing it.

Q. Well now, why, again getting back to this question of public interest as against a benefit, what makes it so beneficial when you bring the gas, and what makes it against the public interest when Edison brings it down via Pacific Northwest itself? A. If the gas is sold to the Southern companies, you have the maximum benefit to the public, and then the gas resold by the Southern companies to Edison. That is your maximum benefit.

Q. Now which situation are you talking about, when El Paso sells the gas— A. It does not make any difference who sells it, El Paso, Pacific Northwest, Pacific Gas & Electric Company, Trans-Western Pipeline Corporation. Whoever sells it to the distributor, giving the distributor the opportunity to make that profit and keep his big customers, as he should, that is the maximum to the public interest.

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Q. You flew out from El Paso to California to talk with a man in Southern California to represent the public interest, is that it? A. We try to work all day long, and sometimes at night, in the public interest.

Q. You were there as president of the El Paso Natural Gas Company, weren't you? A. That is right, and we consider that we can only do our business—it is a public business, we are in a sense a public utility—we can only do it by studying and trying to serve the public interest.

Mr. Bernnett: No more questions, thank you, Mr. Kayser.

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Mr. Standley: Mr. Examiner, I have received a letter from James Ludlum, First Assistant Attorney General of the State of Texas, in which he stated he could not be here, and has asked me to direct a few questions to Mr. Kayser.

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Q. Mr. Kayser, you testified on direct that El Paso had purchased a great deal of residue gas in the State of Texas and the swing occurring from a change in one allowable day is from 40 million to 50 million cubic feet per day. Would this proposed merger enable El Paso Natural Gas Company to improve its ratio between residue and dry gas? A. Yes, sir, as I testified this morning, we are working at that all the while, and the gas that we would gain access to in this acquisition of Pacific Northwest Pipeline would be gas that was situated closer to dry gas, and that is true in the Rocky Mountain region and in Canada. And we would expect to improve the ratio immediately upon the merger. It would show.

Q. Is that a correct figure, that 50 million for one—A. Forty and 50 million cubic feet of gas a day for

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each.

Q. For one each allowable day? A. For each allowable day.

Q. Mr. Kayser, does that take into effect the reduction in barrels in New Mexico, too? In other words— A. Yes, I think it does. It takes into account the effect that arises out of the reduction in Texas, which has a reflected reduction across over into New Mexico.

Q. Almost always, of course, we get ours when they get theirs. A. That is right, that is what happens.

(1624)

Q. How would this merger enable El Paso to purchase more residue gas in the State of Texas? A. It would enable us to purchase more gas in the State of Texas because we would have, number one, by the merger itself, improved our residue dry gas ratio because practically all of the 500 million to 600 milliion that Pacific Northwest will be delivering is dry gas, and you add that to our present deliveries of dry gas and you will raise our ratio immediately. Now in addition to that, the access in the future to additional dry gas reserves will make us able to buy residue gas in Texas and New Mexico, and at the same time buy dry gas in these other areas, and do it on such a basis so as not to get our ratio out of joint like it was a couple of years ago.

Q. Before El Paso started taking this residue gas from

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Texas, what was being done with it? A. It was burned in flares in the field, either right at the separator, at the mouth of the well, or if it were gathered into gasoline absorption plants, then in a huge flare at the plant.

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Q. Will you please state whether or not El Paso Natural Gas was the first major interstate pipeline to begin the taking and marketing of residue gas for beneficial use? A. Yes, in volume. And certainly the first in the Southwest. Some of the gas in the Appalachian region, which has been using gas for a long time, they probably did gather it from the oil wells very carefully. I do not know anything about that.

Q. When did you start that, Mr. Kayser? A. We started it—now let me think a minute. The first contract we made with Phillips Petroleum, I believe, was in 1939 to take residue gas. I think that is right.

Q. As a result of your efforts, most of the Conservation

Commissions in the western states have required the non-flaring of gas now, haven't they? A. Well, I can speak for Texas, and they simply, if it is within reach of our pipeline, why they have actually shut fields in, or issued orders for the shutting in in the future unless the gas was connected up. And we have made a point, of course, not because we are nice people and all that, but because of good business, to go cooperate with the Texas Commission and with the producer in trying to avoid the shut-in of any field, and have pretty well done it.

Q. You testified on direct 90 percent of the potential of Pacific Northwest is dry gas. Is that right?

A. I expect it is higher than that, but I will let that stand.

Q. The only real oil field in that group is Rangely, isn't it? A. That is right.

Q. The rest of them are gas fields? A. I think that is correct.

Q. Would this merger operate to increase El Paso's capacity to purchase more Texas residue gas? A. Yes, it will do just that.

Q. If the merger is approved, is it your conviction that your company would probably purchase more residue gas? A. Yes, we certainly will.

Q. Understand I am reading these things, I did not write them. A. Well, I say yes.

Q. If the merger is approved, El Paso Natural would control most of the production in the Rocky Mountain region, a large percentage of the production coming from the San Juan Basin, and at the present time some gas coming from Canada. Based on this assumption, would this mean that less gas would be purchased in the State of Texas by El Paso? A. No.

Q. Would it affect— A. I would like to elaborate on that just a little bit.

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Q. Fine. A. Because I think it is correct to say that the national policy, and it should be our policy, is to buy gas, import gas, only to supplement the supplies of domestic gas. That is the policy we have, that is what we would like to abide by. And we would be interested in buying gas in Texas just as vigorously as we have in the past.

Q. I believe that you have testified that gas produced from Canadian sources and Big Piney in Wyoming, and the San Juan area is substantially all dry gas and can be controlled to a great extent by purchasers. Would this make available large quantities of gas if needed, or curtailment thereof if not needed, on reasonably short notice under existing agreements? A. Yes, I assume that what Mr. Ludlum is referring to is the flexibility of operation in taking care of the deficiencies of the deliveries, variable deliveries, of residue gas. The purchase of this other gas would help that materially.

Q. Please state whether or not this would be of benefit, or would it be a detriment, to the producers of residue gas in the State of Texas? A. It would be a benefit because you have to remember now that when we are connected to a gasoline absorption plant, and that is where the residue gas comes from, it would be true of anyone, it would not make any difference, whoever is connected to it, if they do not take it, it has to be burned

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to the air, and the producer loses right that many. So that our capacity by our whole system, through its flexibility, being able to go up, up and down in our takes, is the thing that is worthwhile and makes money for the producer and saves the gas as a conservation measure.

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Q. You testified that one of the principal purposes of El Paso in purchasing this merger was to make connection with the large, undeveloped gas reserves in Canada. Do you feel that the availability of these reserves to the old El Paso system will in any way adversely affect the interest that is stated in New Mexico?

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A. No, I don't. I have discussed this with a lot of people, and I think that in the long view the people of the State of New Mexico will reap advantages from the attachment of this system to the reserves of Canada.

Q. Would you explain that first from the point of view of the producers, and secondly, from the point of view of the consumers? A. As far as the producer is concerned, I think we are going to take all the gas that we can put together in New Mexico, so that I think that he is going to get plenty of market. He has attached all the market there is in that area. Now so far as the consumer is concerned, it is true that there is plenty of gas in New Mexico for the consumers in New Mexico, but you can not build a dam around it, because the United States Constitution won't let you do that. So it is going on to market anyhow.

Now when the system that serves you, as the El Paso system does, by its direct connections and by its sales to Southern Union and the other little companies—not little companies, the other companies—that serve New Mexico, the fact that we have access to the largest potential supplier on the continent will necessarily lengthen the life of the service of gas in New Mexico.

Q. Is it one of El Paso's long range objectives to make Canadian gas available through its system to the ever-increasing

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California market? A. Oh, yes.

Q. Now you have said, in connection with that, that you intend to use the imported gas to supplement. A. Yes, sir.

Q. I presume by that you mean that you are going to use the Permian Basin-San Juan-Rocky Mountain gases as your primary service— A. Primarly in the sense of first.

Q. That is what I mean by primarily, too. A. I think that is the order.

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Q. Does the acquisition of Pacific Northwest make El Paso the sole pipeline purchaser of natural gas in the San Juan Basin? A. No.

Q. Who are they? A. Southern Union, and Southern Union—I corrected myself, as to its being a little company. It delivers something in the range of 150-160 million feet of gas a day. We buy a substantial amount from them. Later we will put in the record the total movement of gas by Southern Union. Then Trans-Western has some purchases in the San Juan Basin and will be coming by in easy access to it.

Q. Those two? A. Those three. Two others.

Q. Does the dominant position of El Paso adversely affect the interest of New Mexico producers in the San Juan specifically? A. I do not think so.

Q. You testified to the effect that the potential of the San Juan Basin had been nearly all used up in the sense that you can pretty well tell what it is going to do. Did you anticipate there will be any substantial increase in the approved reserves of the San Juan Basin above those you have now— A. Yes, I qualified that later by saying that the

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deeper horizons had a substantial potential, beginning with the Dakota and going on down through the Mississippi and Pennsylvania. Now they happen to have been explored out in the deeper portions of the basin, and we are making a determined effort to explore for them, and are having some success so that there is a substantial potential below the Mesa Verde in that basin. But from the standpoint of exploration, except vertically, there is not much else to be done.

Q. You feel that you have marked the circumference boundary of the basin? A. That is right, the lateral area is pretty well defined.

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Further Cross-Examination

By Mr. Kurtz:

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Q. Now, you have mentioned the fact that you had gone into exploring for gas in the Southwest Wyoming and South Big Piney-Pinedale area. I don't know if the record is clear, but you went into that a number of years ago, did you not? A. Yes, sir.

Q. About when? A. Fifty-one or fifty-two.

Q. That was about the same time that there was considerable talk about a large supply of gas in the Church Buttes area? A. Yes, sir.

Q. Now, you mentioned the fact that if El Paso wanted to move the gas from the Big Piney area by an independent line, then there would be a duplication of costs. El Paso would not

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undertake to build a line in competition with—I mean adjacent to the facilities of Pacific to the Big Piney area, would they? A. If they were independent corporations and we had a large enough supply in that area, we would.

Q. As of today, you do not have a supply sufficient to justify the building of the line, do you? In that connection? A. No, but before this last contract was made, there was enough to justify a pipeline.

Q. Now, let's see. Do you mean to say that as of today you have enough proven reserves and deliverability, say out of the Big Piney area, to justify the building of an independent line from that area? A. Not now.

Q. Not now? A. Not now, but before this last contract was—

Q. What do you mean by "before this last contract?" A. Well, the one entered into by Pacific Northwest with General Petroleum. And likewise, the contracts that we entered into with Belfer.

Q. But that hasn't turned out so well? A. No, but it turned out with something. And when you put those two together, you would have in excess of 150 million feet of gas.

Q. And where would you take that to?

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A. Well, we could take it a lot of places.

Q. Well, where? A. Well, I think that by combining another fifty, which could be done in the Wyoming area, you could take it to California.

Q. And that would be just as economical to do that as it would be to move it through the Pacific line. Is that what you are saying? A. No, I don't think it would be. I think the economic way to do it is like we are doing, moving into the Pacific system and take it out of the Pacific system in the fashion that we are taking it out.

Q. Well, actually, today, you are faced with a similar problem in the Permian Basin relating to the Gulf gas supply there, are you not? A. Yes, they have a sufficient accumulation to justify a line which would be exactly paralleling ours.

Q. And the El Paso Company is taking the position that it would mean a duplication of facilities which would not be in the public interest, isn't that correct? A. No, not in the case of the Transwestern. We haven't taken that position in the Transwestern case.

Q. Well, you filed a petition to intervene. Wasn't it an application by the Gulf Company? A. It is an application by the Transwestern—

Q. I'm not talking about the Transwestern. I'm talking about a proposed abandonment for the— A. Oh, I know what you're talking about.

Q. Well, if you know what I'm talking about, let's find it out. A. You're talking about an application by the Gulf Oil Corporation to abandon a service through a gasoline absorption plant to which it is now selling casinghead gas.

Q. That is right. A. And we are taking the residue from that plant.

Q. That is correct. A. And if Gulf abandons that service—I don't know to whom they have sold it. I expect it is to Transwestern. Now, we say that there is a disrupting thing that will cause our facilities that are in being, constructed, and serving, to be idle by reason of taking this out and putting them in new facilities that might be constructed.

Q. Well, in other words, what you say, "idle." You don't mean that they wouldn't be used, but that they wouldn't be used to capacity? A. They would be idle to the extent that that was permitted to be disconnected.

Q. That is right. I'm thinking of 30 million, and it is that much, you are still taking a great deal more gas through that line, aren't you?

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A. That is right, but nevertheless, idling by that amount of it.

Q. In other words, the facilities would not be used to their capacity? A. That's correct.

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Q. All right.

Now, another matter that I haven't quite followed you on. You were talking about the extensions in the Pacific Northwest area, the area that it serves, and I believe the extensions that you have in mind are to Eugene, Oregon, as one? A. Yes.

Q. Now, where else are you planning on extending the

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Pacific system? A. We are looking at some areas in Washington as well, and we are looking at a further extension beyond Eugene—Springfield, to a place called Roseburg, I believe. And there is also substantial talk about the possibility of a paper company's locating there, and at Klamath Falls.

Now, in the case of Klamath Falls, we would expect to serve that, as I outlined yesterday, by a tap off of the P.G. & E. line that will go by fairly close to that.

Q. Yes. Well, in Oregon, you have the Klamath Falls. That would depend upon the line of P.G. & E. A. We might be able, if they can pay a little extra cost, we might be able to bring it over to Roseburg. But I understand from the organization—

Q. You mean from Roseburg to Klamath Falls? A. Yes, we understand that it is a bad area, but it can be done.

Q. I don't doubt that, that physically you can build a

pipeline, but I'm talking about economics, too, Mr. Kayser. It couldn't be done. A. It would be doubtful. Now, let's clarify that. There are negotiations for a paper company to be put in there. Now, that does change the picture, but it doesn't change it enough to justify it on the rates that have been promulgated. They would have to pay extra amount. Now, how much they

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can afford I don't know, but it is a possibility. That would take care of itself, if they can connect it to Klamath Falls.

Q. And your facilities to Rosenburg would depend on construction of a paper mill at that point. That is what you are thinking of, or some other industry? A. That is right. One other. There are two in there now. If they can put one other, she's all right.

Q. But your line to Eugene does not depend on any new industry? A. No, that has already been surveyed sufficiently to justify building it.

Q. Where in the State of Washington do you have in mind? A. We are surveying and have probably completed the possibility of a line over to Gray's Harbor. Now, that is dependent upon getting certain loads on firm contracts. I don't know at this time whether we can get them or not.

Q. Any other place in the State of Washington? A. Yes, I think that as—this I have not surveyed, but I believe that as you come down from Pendleton—I remember flying over that country—there are some substantial little towns through that area, and we again would expect to take off from the P.G. & E. line and serve them.

Q. Has any of those little towns in that area around Pendleton requested service from you?

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A. No, we have stayed out of contact until we get our arrangements with Pacific Gas & Electric.

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Presiding Examiner: When you speak of Pacific Gas & Electric pipeline, you are talking about what is shown here on this map, which is Exhibit 1, as Pacific Gas Transmission Company?

The Witness: That's right.

Presiding Examiner: Which I assume will be a subsidiary or an affiliate or some such of P.G. & E.?

The Witness: That is correct.

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Q. Mr. Kayser, you testified at some length about the merged system would allow more gas to be transported through the pipeline. Isn't that right? A. Yes, sir, particularly Pacific Northwest's pipeline.

Q. Would that mean that in the future, when the demand for gas increases in Idaho, there would be more gas available

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to the people in Idaho? A. Yes, sir. We have pursued this policy, which, it seems to me, is the correct one, namely, that where we carry large volumes of gas beyond a given state or a given community for sale to others, at the same time that we make provision for the capacity to serve that big demand, we canvass the situation and make provision to serve any demand that is intervened between the source of supply and the point to which you have taken the large volume.

Now, that is particularly true of New Mexico and Arizona in relation to taking gas to California, and it would be exactly true in respect to Idaho in bringing large quantities of gas down to any of the present El Paso markets.

Q. Well, in Arizona and New Mexico, you have testified that you have the policy of furnishing gas to every community that you can. Now, will you follow that in Idaho,

too? A. Yes. That isn't because we want to be great benefactors, and we don't want to be in the attitude of guardians of the public. That isn't what we are trying to do. We are trying to handle the business on a business basis, and we regard the demands of that portion of our market area that is back from the Coast as being among the most important. We think there is probably going to be a very great growth there, and in addition, they are going to be—that is, B.T.U.'s are going to be—scarcer in that area than they are along the

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coast, and it would be easier to serve them from the standpoint of public relations, and we think they ought to be served and we'll serve them.

Q. Do you think that under the merged system, in your opinion, that will be the most economical way to bring gas to the Idaho consumer? A. Oh, yes. There is no question about that. As you bring through the large quantities in a high pressure, large diameter pipeline, you get the lowest unit cost of transportation.

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Cross-Examination

By Mr. Letton:

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Q. Now, you referred at one point to the fact that the Pacific Northwest system was originally built to bring gas from the San Juan Basin and certain Rocky Mountain areas northwesterly into the Pacific Northwest states, but that later on Canadian gas became available to the Pacific Northwest states; is that right? A. That's right.

(1702)

Q. Now, the record shows, does it not, that this change in circumstances has resulted in a considerable amount, at the present time, of idle capacity in the Pacific Northwest system? A. Yes.

Q. And I assume that the costs associated with that idle capacity may be said to relate to the present Pacific Northwest system; is that right? A. Yes, it is an incident of the system as it is now constituted.

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Q. Along that line, Mr. Kayser, there has been testimony here regarding the need of Pacific Northwest for additional market and the spare capacity in Pacific Northwest's system at the present time. There has also been testimony that, among other things, the California market and the Rock Springs project in particular will materially improve the Pacific Northwest situation in the future. This doesn't mean, does it, that the Southern California companies will be asked at any time to bear any greater share of the Pacific Northwest system costs than are reasonably related to the use made of that system by such companies? A. That is the theory we are proceeding on. That is the principle we are proceeding on.

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Q. And in order to determine the proper share of such costs to be allocated to the Southern California companies and other customers, would you be willing to maintain records covering costs incurred on the Pacific Northwest system in such a way that would facilitate the determination of those cost allocations? A. Yes; if the Commission says that we should do it, why, we'll be glad to do it.

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By Mr. Grenier:

Q. Mr. Kayser, when Mr. Morrison, the Arizona attorney general, was talking with you last Friday, did I correctly understand you to say that the merger, of itself, would cause

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no increase in rates for customers in the State of Arizona? A. That is right. We are not proposing any increased rates as a part of the merger to anybody.

Q. Do you visualize the merger, even though no such rate increases are now proposed, as likely to cause any rate increases in Arizona in the future? A. No, sir, I think the effect of the merger—I think we tried to show it, and it is my judgment and firm conviction that we'll reduce costs. Now, when it reduces costs, it will be reflected in a lower rate.

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Q. Moving back one state further east, do you visualize the proposed merger as likely to cause any increase in your rates in that state? A. No.

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Q. Well now, this may possibly be a thing that we ought to ask of one of the technical witnesses, and if so, please tell me so, but I'm trying to figure out how much of this gas, say in the year 1962, which would be the first year of operation, is expected to come, say, from the San Juan Basin, and what proportion of it is expected to come from Big Piney or other Rocky Mountain areas, or what portion from Canada? A. Well, I don't think anybody can tell you that, because you would have to have a schedule of peak deliveries throughout that period to know. The quan-

(1709)

tity that will come down from Canada will vary, depending upon the peak demands in the Pacific Northwest area.

The quantity that will come down from Big Piney will depend upon the peak demands in that area and in the other areas served by the company.

The quantity that would come up from San Juan Basin would be dependent upon both of those.

Now, as those demands vary, your quantities would vary

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from each of those points. I have investigated the same thing you are talking about, and there will be times, in low peak demands in the Northwest, when a very substantial amount of gas will come down the line, all the way down to Rock Springs, and some of it will go—well, in fact, a substantial amount of it will go right down the Rock Springs line. Then at times a very high peak demand up in the Northwest—I don't remember exactly, some very small amount of gas will come down, if any. Even under our plan, gas can go up that way to take care of those peaks.

So when you get gas coming in in those various intermediate places, you have to play it a good deal like a pipe organ. That is, it can come from any source.

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Q. Now, is the Kingsgate project, in your thinking, dependent upon the consummation of the merger that is immediately involved in these proceedings? A. I would say this, that if the merger is not granted, there is going to have to be a lot of new planning to be done to be able to take in the Kingsgate gas. Let's put it that way.

Q. Certainly. Of course, the merger isn't dependent upon Kingsgate? A. No, no; no, it is not.

Q. Now, looking at the last set of relationships here, is the Rock Springs-Las Vegas project dependent upon consummation of the merger, or vice versa? A. I think that the Rock Springs project, Rock Springs-Las Vegas project, could be carried out. I don't say that it would. I say it could be carried out independent of the merger.

Q. And, of course, the merger could be carried out independent of the Rock Springs-Las Vegas project. A. Yes, that is right.

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Q. Now, one thing that was done in all of these studies, as I have interpreted them, was that gas purchase and production costs for the entire system were rolled in together for

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purposes of being allocated to all of the system's customers? A. That is right. That is the way we understood them to be done.

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Q. Referring to the Commission's letter, the Commission's staff letter of August 18, 1958, which was read into the

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transcript at pages 639 and following, it says here on page 640 of the transcript, and I quote:

"In this connection, your response indicates an apparent misunderstanding of item 6 of the Commission's letter, which contemplated an allocation of the system cost of service for the merged system, not by division into the separate entities corresponding to the present operation, but rather by the methods customarily employed in rate proceedings before the Commission. Therefore, you are

requested to submit immediately the information requested in said item 6''—of the Commission's letter—''for the company as a single operating unit.''

You interpreted this language, then, as calling for a roll-in of system production, and gas purchase costs? A. Yes, that is correct.

Q. And thought that it indicated that you should follow as nearly as might be the patterns which the Commission had made use of in similar proceedings? A. That is exactly our thinking.

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Q. Comparing the four general areas that we have been talking about here as sources of gas, the Permian Basin area, the San Juan Basin area, the Rocky Mountain and the Canadian

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areas, where would you anticipate in the next three to five years the greatest upward pressure on gas costs? A. I think the Permian Basin is by all odds the place where the highest pressure is now being exerted, and will continue to be exerted.

Q. Would there be any difference in what you have just told us if the merger is disapproved, instead of being authorized? A. No.

Q. Would those pressures be any different? A. It hasn't a thing in the world to do with it. I'm a little inclined, if the merger is denied, it might increase the pressure on the Permian Basin, because we would be limited in our purchases. Whatever limits us in our purchases will increase the pressure in those places where we are not limited.

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The Witness: I mean by limiting us in our purchases, limiting us as to areas in which we would be in a position to purchase.

By Mr. Grenier:

Q. You would have less places to go, and therefore would

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be squeezing harder at the ones where you can go, is that your theory? A. That would be the normal effect of it.

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Q. You have spoken several times of the fact that the merger will give El Paso access to Rocky Mountain and Canadian gas, and have cited this as one of the great advantages of the merger. Won't many of these advantages still be available to El Paso even if the merger doesn't go through, Mr. Kayser? A. No, I tried to explain that very thoroughly. I think we have to separate the two companies very thoroughly if the merger doesn't go through.

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Q. As a result of the merger—this may be a little repetitious, but I want to just pinpoint it again, if I may—as a result of the merger, do you visualize any gas to be flowing into Texas, New Mexico or Arizona from either the Rocky Mountain area or Canada, which would not have flowed into those states without the merger? A. Yes, but that is a long time down the road. Logically, the gas in both Texas and New Mexico is going to be exhausted prior to the gas in the Rocky Mountain region or Canada.

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Now, the pipelines will be there, and there is nothing you can do with them effectively except put gas through them. I can easily visualize, in fact, I do, I think that that ultimately will happen. It is a long way down the road, but I think it will happen.

Q. How far is "a long way down the road"? Is it ten years, fifteen, or a shorter period than that? A. I wouldn't say fifteen years. I don't believe it will happen in fifteen years, but the service, we hope, is going to last much longer than fifteen years.

Q. Well, the fact, then, is, is it not, that in the fairly short-range future there just will not be any more gas coming into these states from these Rocky Mountain and Canadian sources that would have come otherwise? In fact, there will not be any? A. That is right. Physically, I doubt that, except in emergencies, in the immediate future, any of it will come down.

Q. You spoke of this Canadian and Rocky Mountain gas as being dry gas, except that which comes from the Rangely Field. You have said, have you not, that this will ease the problem which you have been encountering because of the large volumes of residue gas you have contracted for in the Permian Basin? A. Yes, it is helpful; very helpful.

Q. This has been very difficult for me to understand, Mr. Kayser. Just how will this Canadian dry gas, say, be of

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assistance in this connection? The physical remoteness poses intellectual problems to me that I have not been able to surmount yet. A. Well, I wouldn't undertake to answer it if it were a very intellectual matter involved. But it is an operating matter which I think is subject to explanation, to my mind. That is comparatively simple. There

will be a measure of excess capacity in the pipelines leading out of Canada, both through the Sumas Gateway and through the Kingsgate Gateway.

Now, that, therefore, in times of shortage of gas anywhere on the system, will permit a slightly larger volume—not a great big larger volume, but a slightly larger volume to flow into the system at those two gateways. That is so far as the Canadian gas is concerned.

Now, so far as the Rocky Mountain gas, the substantial excess capacity in the lines leading, for instance, from the Big Piney and from the other sources of supply into the present Northwest system, those additions, just offhand and I could demonstrate it, I am sure, with a flow sheet, would give us at least, we'll say, 50 million. My judgment is it is 100 million. I would rather say 100 million that you could get out of those sources for a short period if you had to have it, or probably for a fairly long period.

Q. Where could you move that 100 million to, Mr. Kayser? A. That is just the point I am coming to now.

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Q. Fine. A. Now, in the Rock Springs-Las Vegas line, there is likewise some excess capacity. There is, at least right now, I'm quite sure, in the lines from the San Juan Basin to California, 100 million excess capacity, and we want to try to keep that much excess capacity from Gallup on all the time. Now, that is our aim, and I suspect we will do it.

Now, by having those excess capacities that can come in at those two places, and by backing off gas in San Juan, instead of pushing it on up towards the markets of the Pacific Northwest, you would supply those markets of the Pacific Northwest with that additional gas. And in that fashion you would be able to make up, through the Gallup and the lower gateways and through the Las Vegas gateway, any shortage of gas, a part of the shortage, at least, of

the gas in the Permian Basin that arose out of residue gas being set off the line.

Those are just physical operating facts.

Q. All this sounds like the areas where this flux and reflux is occurring is out in California and possibly in Arizona. But let us just take a place like, oh, say, Clovis. There just cannot be anything but Permian Basin or other Panhandle area gas for Clovis, can there, Mr. Kayser? A. Yes, but the point is that that portion of the gas that comes by Clovis, either way you are going, whether it is going out or coming back, can be regulated by the amounts of

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gas which you take care of the market with otherwise. That is right. So that when you get gas into a system with the flexibility of the points, the gateways to the market that this system has, you can make available that gas at practically any point on the system. That is the fact about it.

Q. Now, I do not remember whether you remember this, but do you recall that the evidence in Docket G-4769 indicated that in 1955, the test year there involved, the Plains-Gallup line was operating on a load factor of a little bit more than 90 per cent? Does that seem about right as you recall the operation of that line? A. No, I haven't the slightest memory of that, Mr. Grenier. I couldn't possibly remember that.

Q. Well, assuming that that is approximately correct, are you aware of any change which has occurred since then in the utilization of that line, or any change that is anticipated in the near future? A. Against the 98 per cent factor?

Q. No, not 98 per cent. It was somewhat more than 90 per cent that was indicated. A. Well, changes like that happen. It did this year. We lost 800 million feet off our

line this year. I don't know what the Plains operated, but nothing like that. These extremely high load factors have been with us since the war because of the very, extremely rapid expansion of the market.

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Q. Well, let me see if we can get at this thing another way. Could you give us any indication as to just how much this swing is that you have been talking about in the Permian Basin residue gas delivery? A. Mr. Grenier, I would like to say this to you: I understand those swings pretty thoroughly. They are there. They run as high as 500 million a day. That happened once, to my certain knowledge. For it to happen 100 million, 200 million, 300 million is not too unreasonable, and, as I have already testified and as Mr. Steen has testified and will submit to cross-examination on, because of the number of outlets that we have on the total system, the effect of it is that availability of gas that we can turn on and off at will relieves the pressure on us, or, rather, gives us an added resource which, when all put together, makes it possible for us to handle the swings that do occur.

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Q. Are you aware of the fact, Mr. Kayser, that in Mr. Dunn's cost allocation exhibits, he allocates to El Paso's present jurisdictional customers in the year 1959 approximately $2,227,000 more cost of service with the merger effective than without the merger effective, and that similarly, in 1960, he allocates to those customers approximately $2,568,000 more with the merger effective than without it effective? A. No, I'm not familiar with that.

Q. Assuming the correctness of those figures, subject to check, would those facts tend to make you modify what you have just told us? A. No, because I have refused to

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rubber stamp Mr. Dunn's system of allocation for anything other than this proceeding.

Q. And of course, you don't know what the rules of Mr. Dunn's work would have been if, instead of following the zone cost allocation theories which he made use of, he had

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followed the more standard Commission patterns? A. No, I haven't the slightest idea.

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By Mr. Furbush:

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Well then, can you tell us whether or not you know, whether by following the methods customarily followed by the Federal Power Commission for the allocation of costs, if there is any way under the present system as it is now composed, of El Paso, to have deliveries of Pacific Gas and Electric Company charged with any costs for the Pacific Northwest Pipeline Corporation? A. Well, I would not undertake to say what the Federal Power Commission can or can not do in respect to allocation, Mr. Furbush. Because—yes, that is a matter of judgment.

Q. Well, inasmuch as there are two separate corporations, is it not— A. Oh, you mean—I understand what you mean. At present, with no merger, certainly, I do not know of any basis upon which any of those costs would be chargeable to Pacific Gas and Electric.

Q. Well now, Mr. Kayser, if the merger goes through, it appears as though if we were to follow the methods customarily followed by the Federal Power Commission in allocating costs, as Mr. Dunn did in his Exhibit 28, that

costs would be assigned, costs of Pacific Northwest system would be

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assigned, in some manner to the deliveries at the California border of the El Paso Natural Gas Company, excluding those to the Las Vegas line; is that not correct? A. If the system of allocation as used by Mr. Dunn were followed, mathematically the answer has to be yes to your question.

Q. Mr. Kayser, are you aware of the fact that Mr. Dunn's method of allocation would assign approximately $3,800,000 per year to the El Paso deliveries at the California border, excluding those in the Las Vegas line for the year 1962, which would be in excess of those which would be assigned to those deliveries if the merger were not to be consummated? A. No, I do not know that because I am not familiar with those figures.

Q. Well, let's assume for the purpose of discussion that that is the case, that under Mr. Dunn's method of allocation approximately $3,800,000 per year would be assigned to those deliveries. Now you have heretofore testified that you do not consider that there should be any of the Pacific Northwest facility costs, or gas supply costs, assigned to El Paso's present customers unless there is some benefit to be derived to those customers from those facilities or gas supply; is that correct? A. That is substantially correct. I said that the costs of these additional facilities should be borne by those

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who get advantage therefrom.

Q. Well now, assuming that what I have said is correct, that approximately $3,800,000 per year would be assigned to the California deliveries, excluding the deliveries from the Las Vegas line, will you please tell me what advantage is

to accrue to the California companies which would be responsible for the incurrence of those costs? A. Well, I assume—well, I know that the Pacific Gas and Electric Company is very much interested in having the maximum length of life of service of gas and, as I have testified before and I will reiterate it here, and the attachment connection of all sources within economic reach has the effect of lengthening the life of the service to all customers on a system so situated. Now in the case of the Pacific Gas and Electric, all the sources of supply in the Rocky Mountain region are physically attached to El Paso's system by this merger. And I think that is quite an advantage.

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Q. Well then, if the merger is to be consummated, then the Pacific Gas and Electric Company will run the risk of having some of those costs allocated to its deliveries? A. I think the attitude about that is that you will not have any cost allocated to you except with a corresponding benefit.

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Q. Mr. Kayser, if you were advising the Pacific Gas and Electric Company at the present time and making recommendations to them, would you say that it was in their best interest to expose themselves to that risk which I have already discussed with you?

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A. I object to the word "expose" and the word "risk", but we are not going to argue about language. You have asked me a question and I am delighted to answer it.

Q. Yes, go right ahead. A. Yes. I think that the Pacific

Gas and Electric Company should, by all means, use, in the interest of its consumers—not in its corporate interest, because it is going to make its dividend and it is going to make its money right along pretty well, whether it does these things or not, but looking at the public interest served by that company, I think it should avail itself of this opportunity to be attached to these reserves.

Now, I am saying that advisedly. I am not saying it arbitrarily. And I am saying, even though you are successful, which I hope you are, and we are doing everything we can to help you be, in making your connection to Canada, because you want to remember that the importation of gas from a foreign country is subject to, generally, the fuel policies or rather—yes, the general policy of our Government, and that is that those supplies are to supplement and not to be used to the exclusion of domestic supplies.

Now, we and others have found more gas in the Rocky Mountain region than we thought was there. I always thought that it was too rough a country, and you were not going to find large quantities.

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Some substantial large quantities have been found where I did not think they were, and more may be found there. And when you do not have a direct connection to those, then you have run a real risk of not getting them. But when you have a direct connection, as you would have it here, you are in a preferred position to get service from it.

Now, let me say this other thing to you. I am willing to say it to all of your executives because they have said it to me. They haven't any notion, neither do we have any notion, of not serving additional gas to Pacific Gas and Electric Company. We only last February made a contract with you for 200 million. All right, I hope that it is true that next year and next year, or whenever you

need it, I hope we are in a position to serve it to you. We would be delighted to serve it to you.

Our ability to serve you will be measured to a degree as to whether or not we have access to these reserves in the Rocky Mountain region.

Now, you asked me if I would advise, and while I want to explain, I am not doing it just for selfish interests; I am trying to justify it from the standpoint of the public. I think that it would be the correct thing to do. I think you ought not to be afraid of whatever allocation might be made by the Federal Power Commission against your consumers. After all the long-range view of the gas supply situation is predominantly in the hands and it is the duty of the Commission to attend to

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it.

I mean to take the long-range view and I think they do—I mean the Federal Power Commission. And when you subject yourself to what you call a risk of allocation, I think it is one that you ought to take.

Q. Well, Mr. Kayser, assuming that none of the parties to this proceeding have any desire to hinder any legitimate aspirations of either El Paso Natural Gas Company or Pacific Northwest Pipeline Corporation, is there not some other method which can be employed whereby your existing gas customers are protected from being burdened, I might say, by some of the costs of the Pacific Northwest Pipeline Corporation system and gas supplies? A. I do not think the costs are going to be anything like what you are envisioning, and I do not think that the risk, as you call it, is serious, because I have testified in the beginning that I think that by improving the deliveries of that company, the leveling out of the costs between the two companies will be surprisingly small in its differential, either way.

My judgment is that inside of three or four years your allocation studies will be a great deal less important than they seem to be today.

Q. I believe I was directing my question toward the proposition as to whether or not there was some method which could be adopted which would more or less restrict the allocation of

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the costs of Pacific Northwest Pipeline Corporation to your existing customers. A. Well, the Natural Gas Act having placed that with the Federal Power Commission, obviously, I do not know how to change it. And I was only saying what I said in the preceding answer to indicate that to accept the risk, as you call it, of the allocation is not a serious thing and will cease to be serious at all, in my judgment, in a comparatively short time.

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Q. But if there were some method which could be employed to avoid the allocation of what your customers might consider to be unnecessary costs being allocated to them by the Federal Power Commission in some future proceedings, it would appear to be in the best interests of those customers to attempt to devise such a method; is that not correct? A. Well, I would not want to be a party to try to devise a method to limit the Federal Power Commission in its discretion in respect to rates.

Q. Well if the Federal Power Commission were, on the basis of representations made to it, to conclude that it would be in the best interest of El Paso's existing customers to, at the inception of this merger, establish a method whereby the costs of Pacific Northwest will not be allocated to El Paso's existing customers, there would be no restriction on the Federal Power Commission from then on inasmuch as they would have assumed that re-

striction? What I mean is, the parties themselves would not be restricting the Federal Power Commission's actions, is that not correct? A. Well, you can not restrict it in the first place because, as you know, as a lawyer, you can not contract against a statute of regulation. And I do not think there is any practical way to condition the certificate upon that.

I will, though, express again to you what I have said, that in my judgment the costs should not be allocated in excess

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of the benefits, and I do not know any way to do that except to leave it to the Commission to hear all the evidence and determine what correct allocation of the costs should be made.

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Cross Examination

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Q. Well now, will you look at Exhibit 246, which is the large map of the system, and at the western end, the far western end of the Arizona-California border, does not this indicate that the Southern California companies received gas from both the Permian Basin over the Southern system and from the Permian Basin over the Northern system through the Plains-Gallup transmission line, and also from the San Juan Basin? The Southern California companies, I am talking about. A. Oh, yes, sure. All those lines are leading into those two delivery points, and they deliver gas.

Q. And with respect to Pacific Gas and Electric, it also receives its supply from all three of those sources, because

of the cross-over line which is in Mohave County in Arizona, and gas flows north in that line and into the northern system?

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A. That is the connecting line, and it can flow either way. I would not want to say on any particular day which way it was going. I mean it is possible.

Q. It is possible? A. Oh, built for that purpose.

Q. And then it is true that 100 per cent of El Paso's California customers do have three sources of supply from the system; that is, from the Permian Basin over the southern system, from the Permian Basin over the Plains-Gallup line, and also from the San Juan Basin? A. Yes, but all your Permian Basin supply is in effect one. Now, let me make a correction with you now, because while you pointed out to me that on that flow sheet you had 113 million feet of gas flowing toward Dumas, the fact is that we have an exchange agreement with Northern, the effect of which is that some 250, I believe it is, million—certainly 200 million—feet of gas that we have in the Panhandle is exchanged for like amount of gas at Plains.

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Getting back to the western end of your system and looking at the Phoenix area of the large map, it is also apparent that Phoenix obtains gas from both the Northern and the Southern system; does it not? A. Yes, sir. We built that 20-inch cross-over for that purpose.

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Q. And so it also has three distinct sources of supply through those methods in the same manner that Pacific companies have? A. That is right, the same manner as California.

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Q. Well when you move east of that line, on the Northern system, you have a section of line between the Arizona border and that line to Phoenix which has supply available from only two sources. It has gas from the Permian Basin over the Plains-Gallup line and also over the San Juan line, from the San Juan Basin? A. That is not quite accurate, I think, in the sense in which you are making it because the existence of that crossover line gives a connection between the two that, whereas, physically the gas might never flow north in that crossover line from Phoenix up north, it could, and by the process of backing it off the effects of supply are obtained for all points east of that line—of that point where the 20-inch takes off down Phoenix. That is right.

Q. Well with respect to the Southern system then east of Phoenix, the entire supply of that line comes from the Permian Basin only? A. Well there again the existence—that is one reason for putting that 20-inch in there, that gives the same power backing off of supply that you have in the other pipes. And at the time you connect those two systems together, as they are

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connected, each one has a value in the service of the customers on either line.

Q. Now with respect to the California and Phoenix customers, if you do suffer a shortage of supply in one of those three sources, it can be made up from one of the other two? A. Yes, that is right. That is the advantage of it in relation to the connection of those lines at as many points as possible.

Q. And that is the flexibility of operation that you have spoken of several times? A. That is right, that is one of the manifestations of that flexibility.

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Q. Mr. Kayser, as far as the merger itself is concerned, there has been a lot of talk about the benefits, and of course one of the most important, or the most important benefit is the

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actual availability of gas. Now under the merged plan, and with the operation of the Thistle-Las Vegas line, the benefit of actually having gas present to use and consume is going to be mainly in California, is that not true? A. I did not say that. Only to the extent that California uses more than anyone else.

Q. You do not anticipate that any of the Rocky Mountain-Pacific Northwest system gas will be used in New Mexico? A. No, I said that this morning, and I would like to repeat it. It is perfectly obvious that there is a great deal of gas produced in New Mexico. I am sure that the total amount produced in New Mexico is substantially greater than the amount used. So that from the standpoint of immediate supply it is not—the merger will not have any immediate effect upon the supply, and its availability, in the State of New Mexico. Now I said that the long-time advantage, obviously, is that your consumers are no different from the consumers anywhere else, that the life of the service is going to depend upon, in a measure, in fact it depends directly, on the extent of the attachment of your market to all sources of supply within economic reach.

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Now, I want to call your attention to the other fact which is just as big as the side of a mountain, particularly in New Mexico. Gas was served in New Mexico to the copper industry and the little towns along the southern border of New Mexico, not at all based upon the demand in New Mexico, but originally based entirely on the big demands of

the copper industry in Arizona. You could not have built the line over to Arizona based on the demands in New Mexico. You would have had to have the demands over in Arizona as well.

Then when the lines were built to California, those areas in New Mexico that I am talking about had the advantage, have the advantage, of the lengthening of the life of their service by reason of the attachment of the El Paso company's system to the many sources of supply in Texas, clear on up into the Panhandle, and now over to Oklahoma, so that while the state of New Mexico does produce more gas than it consumes, it is highly doubtful—in fact, I am willing to stick my neck out and say that a very large number of the communities in New Mexico would never have been served, that I can see, for a long, long period except by reason of the bringing of a large quantity of gas through New Mexico. The demands of those little communities were not sufficient to justify the building of a pipeline, the principle being, with which anyone who has any contact to amount to anything with the pipeline business knows, that your cost of transportation, unit cost of transportation,

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is the direct product of the quantity to be served through the pipeline. A 6-inch pipeline cannot be built very far to serve anybody.

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Presiding Examiner: Just asking you this question for my own enlightenment as I go along with the case, you have this allocation study by Mr. Dunn here. Is there any judicial estoppal or anything brought about by it, or is there any binding effect of it by reason of its being in this?

I mean, binding effect, say, in a future rate case or any such? I do not think there is.

Mr. Grenier: I think you put your finger on one of the critical problems of the case, Mr. Examiner. We just cannot produce anything of that kind with a binding effect here.

Mr. Kurtz: No more than any other testimony here. But it is just as binding as any other testimony here.

Presiding Examiner: I understand. Upon the issue of whether or not a certificate should be issued by the Commission authorizing the acquisition of Pacific Northwest's facilities by merger—that is the issue before us now. There is no rate issue before us.

Mr. Shannon: That is correct.

Presiding Examiner: That is why—

Mr. Shannon: And the Federal Power Commission has continuing jurisdiction in rates. Circumstances change; you

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cannot bind the Commission now as to what it is going to do. That has been decided many times.

Mr. Kurtz: You must remember, though, Mr. Examiner, what the rates may be in the future is an issue in this case.

Mr. Grambling: Is what, Mr. Kurtz?

Mr. Kurtz: Is an issue in this case.

In other words, it is the effect upon the consumer. It is an issue in any certificate case, whether it is a merger or whether it is other, and it is properly so and recognized by the Commission in its rules.

Presiding Examiner: I know this allocation study is required, it has to be put in. I realize that. That is what I asked the question for, so you gentlemen can be thinking about it. I have sat here and thought about it, what effect it is going to have.

Mr. Kurtz: I do not think there is any limitation, particularly in a merger case, where you are going to draw

the line. It is one of the broadest proceedings that is ever before a Commission.

The question of rate may be—and there are various other questions on other matters that come before. Here you have a bringing together of two companies under one management and what you are interested in is the effect upon the consumer, the effect upon the company, stockholders and many things that enter into it. I would not attempt at this time to name all

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the issues.

Presiding Examiner: Going further, merely thinking out loud, all I am asking you is, is this binding on any future rate case?

Mr. Kurtz: Oh, no.

Presiding Examiner: All right, that is all I wanted to know.

Mr. Kurtz: I do not know how it could, because one rate case never binds another one.

Presiding Examiner: It seems to me there can be no aggrievement when there is no dollar impact at the present time on the consumer. It is merely a question of determining the public interest, and you must have some general idea of feasibility, you must have some general idea whether it is going to be an exportation of the customer—I realize all that. That is what the purpose of the certificate proceeding is.

But when you get down to dollar impact, it does not come about until the rates are changed.

Mr. Kurtz: Dollar impact on the company is shown by the Dunn study, I mean, on the consumer. That is shown by the Dunn study. That is the best we have at this time, and that is what we are talking about: What is the consumer interest? He is interested in service, he is interested

in how much it is going to cost him. And there is one of the issues, cost.

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Presiding Examiner: And as the witness for El Paso, Mr. Kayser, has said, for that purpose I recognize Mr. Dunn's study.

Mr. Furbush: It shows the exposure, Mr. Examiner.

Presiding Examiner: Of course.

Mr. Grambling: But it does not show any more. It does not show the dollar impact. It shows what it might be if the Commission approves that rate, Mr. Kurtz.

Mr. Furbush: And therefore it must be taken into consideration by the Commission for the purpose of determining whether it is in the public convenience and necessity to approve a merger which, on the basis of the record, will allocate certain costs to the customers as shown in that particular exhibit.

Mr. Kurtz: You are certainly correct.

Presiding Examiner: Well, unless I am directed to do so by order of the Commission, I am not going to make a rate case out of this—whether they are lawful under Section 4(a) or 4(b), whatever it is, of the Act. I am not going to do it unless directed to do it.

Mr. Kurtz: I think maybe what you are saying, Mr. Examiner, you are not going to come out and say this is going to be the rate in the future, but you are interested, I believe, in the cost and the impact upon the consumer.

Presiding Examiner: I think so, and for that purpose;

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yes.

Mr. Kurtz: Certainly.

Presiding Examiner: But I have gone into this just thinking out loud. I do not claim to be an oracle or anything of the kind, or the smartest man on earth. I just wanted a little enlightenment.

I have it, gentlemen, and I thank you.

We are in recess until two p.m.

(Whereupon, at 12:30 o'clock p.m., the hearing was recessed, to reconvene at 2:00 o'clock p.m., the same day.)

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Stuart F. Silloway

was recalled as a witness and, having been previously duly sworn, was examined and testified as follows:

Presiding Examiner: If you desire to go first, Mr. Kurtz, proceed, sir.

Cross Examination

By Mr. Kurtz:

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Q. And if you had continued as President of that company and had remained independent, you could have done just that, could you not?

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A. Well, Mr. Kurtz, whether I would have had the ability to bring that about or not, I do not know. But Pacific faced a substantial number of problems. It might have been necessary to request a larger rate increase than we in fact did, and—well, a number of other things might have been necessary that we did not, in fact, do.

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Q. So we can have a point of time in your testimony, I believe it was on November 3, 1956, that the Pacific-El Paso agreement was signed? A. Yes, I think that is right, Mr. Kurtz.

Q. Now, at the time of that agreement, or shortly thereafter, I believe you sent around a memorandum to the employees of Pacific Northwest relating to their jobs, did you not? A. I don't recall sending a memorandum around, Mr. Kurtz.

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Q. There was a considerable discussion, I presume, that went on in the company relating to what would happen to the employees in the event of the merger? A. Yes, sir, there certainly was.

Q. And what steps did you take at that time in regard to that? A. Well, I undertook to assure the people in the Pacific Northwest organization that in the initial stage it was contemplated that the two companies would be operated separately, and that they were all required, it was a new organization that we had, as you know, just put together, and it had been selected with considerable care, and we knew that those people were all essential in their jobs, and we urged them to feel that way.

Q. In other words, you felt in your mind that they would not be replaced? A. Yes, at that time.

Q. Am I correct? A. At that time, yes, sir.

Q. You say "at that time." Has something caused you to change your mind? A. Well, no. No, Mr. Kurtz. I have always felt that somewhere, at some later date, there would be an actual physical merger of the two properties, and at that time, you have to take a separate look at the personnel question. But

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that was not up at that time.

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Q. Did you ever advise Mr. Fish that he could not finance a pipeline to sell gas to either P.G. and E. or this Southern

Edison Company? A. Well, neither of those questions was ever asked me specifically in that manner, Mr. Kurtz.

Q. Well, whether they were asked or not asked, did you tell him he could not finance it?

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A. No, sir, I don't think so, because neither of those projects ever became, in my judgment, close enough to reality for me to give much thought to them or really give any thought to them.

Q. There is no doubt— A. I'm sorry, could I interrupt?

Q. Certainly. Pardon me. I think I interrupted you. A. What I meant by that is I didn't think they came close enough to reality for me to think whether we could or could not finance them.

Q. When you went to San Francisco and talked with Pacific Gas and Electric Company, you thought you could deliver that gas, didn't you? A. Do you mean from the point of view of whether we had the gas, or—

Q. You went over there with a proposition, didn't you, to furnish gas to Pacific Gas and Electric Company, along with Mr. Fish, didn't you? A. Yes, sir.

Q. Was there any doubt in your mind that you were unable to carry through that proposition that you were making to them? A. Frankly, Mr. Kurtz, I didn't think that we were going to sell any gas to the Pacific Gas and Electric Company.

Q. All right. A. We had not received any encouragement from them

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earlier, and it became apparent that we were not getting any encouragement in the conversations at which I participated.

Q. But you did go along, though, with the hope that possibly it might lead to a proposal to deliver gas to them, didn't

you? A. Well, Mr. Kurtz, from my point of view, I was sort of going along for the ride, as it were. I didn't feel that P.G. and E. was going to buy any gas from Pacific, and we had all the problems in Pacific that I thought I could possibly take under my wing, so I really didn't busy myself with the question of what would happen if, in the remote contingency that a reality of sale did exist.

Q. In other words, what you are saying is that you didn't give it any consideration one way or another? A. Well—

Q. You went along for the ride. A. I didn't worry about it, Mr. Kurtz. I didn't really consider how we would deal with the problems that such a sale would present to Pacific, because I just didn't think that we were going to do business.

Q. All right, so you gave it no consideration at all? A. That is right.

Q. As I understand it, in the early stages of Pacific's initial operation, the earnings did not materialize as expected. Therefore, it was necesary that all the operating and

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maintenance expenses be held at an absolute minimum. Do I understand your testimony that way? A. Yes, sir.

Q. In other words, you were all working hard? A. Yes, sir.

Q. And could you have continued operating that company with the personnel that you had? A. I think not, Mr. Kurtz. I think we had too few in personnel, and I think we asked too much of some of our people, quite frankly; that is, for it to go on for a protracted period.

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Q. When you say "go on for a protracted period", what do you mean—several years? A. Well, I think it would have been very unfair to some of them to go on for several

years. I think it is something that we just couldn't do too long, or too much longer; let us put it that way.

Q. Let us say you could not do it for more than one or two years? A. Well, perhaps two or three. A couple of years I think you could, Mr. Kurtz, but I think any beyond that I would have some doubts about, and some real reservations.

Q. Now, one of the reasons that the income did not materialize, I believe, was the products sales, which netted about three cents per gallon, as compared with 4.25 cents that were used in the estimates.

Do you recall that statement? A. Yes, sir. We realized a little bit more than 3 cents net back to the plant.

Q. Well— A. Yes, sir, but it was a very disappointing result.

Q. At the present time, in your estimates in this case, I believe that you are using a price for natural gasoline of a little better than five cents; for propane, better than 4.25 cents, and for butane, 3.9 cents. A. Those figures— are they net back to the plant, or

are they market prices?

Q. Price per gallon, sales of products extracted from the natural gas. I call your attention to the figure in 1958 of natural gasoline, price per gallon, 5.170 cents; propane, 4.56 cents, and butane, 3.910 cents. That would show, the way I look at it, and maybe I am wrong, that the price position for the byproducts is improving? A. Yes, I think it has improved somewhat, Mr. Kurtz. The volume is still disappointing. The price has improved somewhat.

Q. Well, that volume is disappointing because you are not taking the gas you had originally planned out of the San Juan Basin; is it not? A. It is partly that, Mr. Kurtz, and also partly because of the fact that the gas does

not contain the quantities of liquids that were originally projected.

Q. We have the three elements that you have just mentioned: Price, the liquid extraction not as great per gallon, and the volume? A. That is right, yes, sir.

Q. And the reason for the cutback in the San Juan, amongst others, was the availability of gas that you had in other places from other sources along your system, is it not? A. You said among other reasons, Mr. Kurtz?

Q. Yes.

A. Yes, that is right.

Q. The fact of the matter is, beginning even as far back as the year 1954, Pacific has paid for gas that it has not taken; is that not correct? A. Well, Pacific has paid for an awful lot of gas that it has not taken, Mr. Kurtz. It may go back to 1954. I know that it does to 1955.

Q. Well, you do not have to get any more detailed than that. A. Well, I knew that it was in '55. I hadn't recalled that it picked up in the fall of '54, Mr. Kurtz, frankly.

Q. And as of today, or as of September 30, 1958, to be more exact, you have paid $6,981,951 for gas that you have not taken? A. I'm sure that figure is right, Mr. Kurtz. Yes, sir.

Q. Now, I believe you mentioned something about the importation of Savannah Creek gas—in other words, at Kingsgate by Pacific, and stated that that was not feasible for Pacific to import by itself. Do you recall that? A. Well, I think it is not feasible for Pacific to undertake that by itself, Mr. Kurtz.

Q. What you have reference to in that is that Pacific does not have a market by itself for the 150 million? A. It does not have at the moment; that is correct.

Q. It is dependent upon the California market for that

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gas, is that not it? A. Yes, sir. It would have to find a new market.

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Q. You were also projecting a line from the San Juan Basin at Ignacio to Salt Lake, a products line? A. That was projected, Mr. Kurtz, by a subsidiary of the Northwest Production Company.

Q. All right. And the Northwest Production Company is controlled by Pacific Northwest? A. Yes, sir.

Q. And I understand that did not materialize, of course, after the merger? A. That is right.

Q. But it advanced, before the stock acquisition it was beyond the talking stage, was it not? A. Well, it was—it may have been beyond the talking stage and in the preliminary planning stage, Mr. Kurtz. We frankly recognized that we had a problem with those liquids that we had down there in the San Juan Basin, that plant not being on a rail siding and not good highway transportation, even. We were trying to think of some way that we could upgrade those products and get a better price for them.

Q. And there is no doubt in your mind that you could finance that line, is there? A. Well, I think that would have been quite difficult.

Q. Why? A. Well, this carries me back a way, Mr. Kurtz.

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Q. I appreciate that. A. To some conversations which were very preliminary at that time. But we didn't find a very receptive market in Salt Lake City for those liquids, and we would have needed some firm, irrevocable contracts at good prices in order to have been able to finance that line. Our initial conversations up there were not too en-

couraging, so we never did, of course, carry it to the point where we had a concrete plan that we went out and sought financing for, but I think it would have been pretty difficult.

Q. Do you think it would have been impossible? A. Well, I don't know what is impossible, Mr. Kurtz, but it would have been very, very difficult.

Q. I don't either. All right. A. At least on the information and evidence we had at that time, it would have been real tough.

Q. You would have had to firm up the market? A. Well, yes, we would, and I think that we could—it could very well be that we would have run into difficulty by virtue of the delay in putting anything like that together in respect of the quantity of liquids that we in fact had. When we were talking about it, we thought we were going to have more than we did in fact have. So I think by the time we got it firmed up, that would have been another negative fact that would have militated against it, pretty much.

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Q. I must have misunderstood this, because I was under the impression that this products line, the economics had all been worked out. I'm wrong in that, am I not? A. Well, the economics—

Q. I don't know. A. The economics were worked out on a preliminary basis, but they were worked out on the evidence in respect of Pacific's acreage in the San Juan Basin, as presented to this Commission, and not on the basis of the actual performance of that acreage after we got into it, if you get the distinction.

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Q. So actually, whether or not it is a holding company or an operating subsidiary of another company, actually,

overall, it doesn't affect the financing, does it? I'm talking about favorable terms. A. Well, I think always, Mr. Kurtz, when a subsidiary company comes into the market to do financing, it does so on less favorable terms than its parent.

Q. Even if the parent guarantees them? A. Oh, yes, I think so.

Q. You think so? A. Yes, sir, I do.

Q. In other words, what you are saying is that if—take, for example, Natural Gas Pipeline Company of America. If it was

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not a subsidiary of Peoples Gaslight and Coke Company, but Peoples owned all the facilities of Natural, they would obtain better terms? A. Well, put it this way. If Peoples directly—I don't know that necessarily Peoples is a good example, but you have raised it.

Q. Well, that is the one I have in mind. A. Yes, sir. If Peoples directly owned all of the physical assets of the Natural Gas Pipeline Company of America, and there were no Natural Gas Pipeline Company of America, just a system the title to which was in Peoples—

Q. In other words, there is one corporation, Peoples, as against Peoples and Natural. A. That is right. I think Peoples could finance the requirements of that component to better advantage than can Natural Gas Pipeline finance the requirements of that component as a separate entity. I think investors always are willing to pay a somewhat higher price, and therefore permit financing on a lower cost of a parent company or of a company that owns something directly, than to do the financing through the subsidiary. They are entitled, I think, to raise the question of what happens at some later date if Peoples gives this company to its stockholders and it becomes and therefore gets out in the hands of the public.

Peoples is no longer responsible for the management. I think that is in the minds

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of investors, actual and potential, and I think that they would prefer making the investment direct, rather than through an intermediary. I think that the financing of a subsidiary is usually a little bit more expensive.

Q. When you say "a little bit more expensive," what do you have in mind? A. Well, that is a good question, Mr. Kurtz, and I don't know that I have the answer for it. But it could be a quarter or a half per cent or perhaps more greater than—

Q. Do you take it up to a half? A. Well, I haven't anything in front of me to go by. I'm just talking general impressions.

Q. Well, I know that is what we are talking about, generally. A. I think it might be as much as a half of one per cent higher in cost. I don't think that would be too much at all.

Q. In other words, the cost of money to that system to issue bonds, they could have saved a half of one per cent, let us say, if they do away with Natural as a subsidiary? A. Mr. Kurtz, please don't put me in a position where I am trying—would be accused of trying to tell Peoples Gaslight and Coke Company how to run their business.

Q. Well, but you are in the security business at this time, are you not? A. I am, and I think that it costs more to finance

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through a subsidiary than it does direct. Now, there may be some other reasons, some other operating advantages, that make this entirely worthwhile to Peoples. But on the grounds of sheer financing, I think that the subsidiary can not borrow on as advantageous a basis as a parent. That is just a broad generality.

Q. Well, if Peoples did all the borrowing, it would save this half of one per cent—I am using that as a figure—is that what you are saying? A. Yes, I think that would be more economical.

Q. All right. Thank you.

Now, wait just a minute. Suppose the same corporate setup exists in that company as of today, but Peoples did all of the debt financing. Would that make any difference? A. Well, you would still—you are drawing the example, now, Mr. Kurtz, in which Natural Gas Pipeline Company of America would have no mortgage bonds outstanding?

Q. That is right. A. The bonds would be issued always by Peoples Gaslight and Coke.

Q. That is right. A. Then the money would be made available to Natural Gas through some kind of unsecured advance, is that so?

Q. Well, that is how it might be. A. Well, I express as a preference, a preferable means

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of financing, Mr. Kurtz, that there not be the subsidiary company unless there is some strong reason why it should be there. I think that is, broadly speaking, this question of utilizing subsidiaries in corporate finance can be overdone. I think there are instances where a subsidiary company is in existence for a logical and sound reason, usually for some operating purpose. But unless there is, I think it is better not to have the subsidiary. Under those circumstances, I think that the credit of the parent company is better.

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Q. Now, you have mentioned the fact that Pacific needed additional income, and that it might be necessary to even

raise the rates higher than those set forth in your rate filing of August 6, 1957. Do I understand you correctly? A. Yes, sir, I have said that, Mr. Kurtz.

Q. Was there any reason in your rate filing that you did make on August 6, 1957, why you didn't raise the rate higher to Mountain Fuel and to Colorado Interstate up to the cost of serving those companies? A. Well, Mr. Kurtz, as I recall it, we put the highest percentage increase on those pipeline companies, including El Paso, and it was a considerably higher percentage increase than there was imposed upon the other customers of Pacific.

Q. Well, according to this rate filing—in order that we understand each other—of August 6, 1957, and I have reference to statements I and J of Schedule 2, sheet 1, and your Sales, Pipeline Company, which are the two I mentioned, show revenues less cost, and a deficiency of $8,348,510. Isn't that what it shows?

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A. Yes, sir.

Q. Now, my question to you is, is there any reason why you couldn't raise the rates to those two companies to recover your cost of service? A. Well, Mr. Kurtz, we did put a disproportionately heavy increase on those pipeline customers at that time. We raised that rate, as I remember it—now, please don't hold me to the precise figure—but from about 21.2 cents, to about 26 or thereabouts. In other words, we raised them about 5½ cents, as I recall, whereas, in the other categories, the increase was considerably smaller. We did go part of the way toward making them pay a larger percentage of the deficiency in cost of service than we did with the others, as I recall it. I think those figures will bear that out.

Q. All right. In other words, you thought that you could

live with the income as shown in your rate filing for Pacific Northwest Pipeline Company, is that right? A. Well, yes, we wanted—I'll be quite—

Q. That is correct, isn't it, what I just said, that you could live with the income imposed here? A. We thought we could at that particular time, Mr. Kurtz. If I could just qualify it.

Q. Go ahead. A. I recognized that we had in Pacific, I thought, inordinately low rates from the initial tariff filing. I was

[redacted]

aware of the fact that it would be necessary for us to importantly increase rates. However, the attachment of business among our customer companies in the northwest had been considerably less than we had anticipated, and quite frankly, I thought that if we pushed those prices all the way up to cost of service, we would further retard the attachment of business and the buildup of load. It was for that reason that we did make a larger percentage increase on the pipeline companies. But we also, of course, increased all customers.

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[redacted]

By Mr. Bennett:

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A. Well, let me just point out that I think a multiplicity of subsidiary corporations in corporate finance does not of and by itself represent the best means of corporate organization. I think where there are subsidiary companies, if there is a sound, logical reason for it, well and good, but I think

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that, broadly speaking, a company that owns all of its physical assets and does not have a multiplicity of corporate layers, if you will, can finance more advantageously than one that has a large number of subsidiaries.

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Q. Now, you were present in Pacific Northwest at the time the Edison contract was executed, were you not? A. The Southern California Edison contract?

Q. Yes, sir. A. Well, it really was not a contract, Mr. Bennett. I think it was just a—I do not know what you would call it. Perhaps a letter of intent, or something of that sort.

Q. All right. A. But yes, I was.

Q. And did you advise Mr. Fish not to enter into that arrangement at that time, such as it was? A. No, I did not. Again, I would like to say, however, that that was merely a preliminary letter of intent, and I certainly had no objection to it at all.

Q. Were there feasibility studies furnished to the Edison Company at or about that time? A. Yes, there were some studies furnished to the Edison

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Company, I am sure.

Q. Do you recall the purport of those studies, as to the practicability of such a venture? A. Well, as I recall the whole transaction, it involved the purchase of Canadian gas by Pacific in the amount of 300 million feet per day and the sale of that gas to the Edison Company at the California-Oregon border. And the Edison Company, it was initially contemplated, would build a line from the California-Oregon border down to Long Beach and—do not hold me to this figure, Mr. Bennett—but as I recall it

involved about $90 million, and the price of the gas at Long Beach was about 51 cents. Frankly, I just never felt that the very conservative Southern California Edison Company would consider that to be economically feasible after they had had an opportunity to process it.

As you know, the conversations also involved an arrangement with Pacific Gas and Electric Company. It was considered as a possibility by which there would not be the passing of those streams of gas in the State of California and there would be, in effect, an exchange of gas with Pacific Gas and Electric.

That would have involved a lesser expenditure by the Edison Company, but would still have resulted in what I thought was a very high expenditure for the quantity of gas. It would not be cheap to them or low-cost to them.

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Frankly, I did not think that those conversations would bear fruit.

Q. But Edison was interested, however, was it not, at that time? A. Well, they evidenced interest, but as you know, it was provided that they had a period of some months, I think December of 1956 was a cut-off date, in which they could withdraw from the conversations if they felt that the project was not economically feasible.

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Q. Well, do you know that Mr. Quinton of the Southern California Edison Company considered that he had such a binding arrangement with the Pacific Northwest Corporation that he would not discuss that particular matter with Mr. Paul Kayser of the El Paso Company? A. No, I did not know that.

Q. Were you given any reason why the Edison Company withdrew from its arrangement with you at that time, or shortly thereafter? A. Well, I think that letter, Mr. Ben-

nett, is a part of the record. I am not sure that I have the exact formal reason that was assigned in the letter in mind, but I tell you, I just felt it was not economically feasible or attractive from the economic point of view to the Edison Company.

Q. Well did you and Mr. Fish at any time discuss the change of heart of Edison? A. Well, we certainly talked about their letter that was received from them in which they terminated the conversations, Mr. Bennett. I am not sure in my own heart that I thought that was a major change of sentiment. As I say, I always felt that the likelihood of that resulting in a piece of business was quite remote.

Q. Would not this have provided Pacific with a market for its Canadian gas and placed it in a good financial position if this had gone through?

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A. Well, I suppose it would, Mr. Bennett, but I just never felt it would go through. I felt there were entirely too many obstacles.

Q. Well, why were you talking with Edison then in the first place if you did not think this thing was possible? A. Well, Mr. Bennett, I was not talking with the Edison Company.

Q. Well then, why was Mr. Fish talking with them, if you know? A. Well, I think Mr. Fish wanted very much to ultimately get attached to the California market, and whether he felt that that presented a genuine opportunity or not I do not know. But I think that somewhere down the road he had hoped that he would attach the Pacific System to the California market—somehow.

Q. And is that why he was talking to the officials of the Pacific Gas and Electric Company? A. Oh, I think so.

Q. Well now, you knew the purpose of Mr. Fish in talking to the Edison people and the Pacific Gas and

Electric Company people, both, did you not? A. Well, I just said, Mr. Bennett, that he wanted to get—

Q. And you knew he wanted to commit your system to delivering gas to California, did you? A. If it could be done, yes, sir.

Q. Well now, didn't you ever at any time tell Mr. Fish

that you did not think this was a good thing? A. Well, I do not think I did, Mr. Bennett. On the other hand, I certainly—I did not work very hard on them myself; I did not work on them at all myself. Frankly, I thought that I had all the problems that I could say grace over at that particular time without thinking about how we could blow the system up much larger than it then was to sell gas into the California market.

Bear in mind that in 1956, in the summer of 1956, when these conversations were going on, Pacific was just constructing its main transmission line and getting itself in business, as it were. And I was more concerned, quite frankly, about whether we had money enough to finish that system. And one of the first things that I did was to conduct a study to that end, which was about the 12th of July of 1956, and found that we did not have, and we had to run out and get additional money. And we just had a lot of problems incident to putting that line in operation. And then as we started to take gas out of the San Juan Basin to load the line, and as we started to staff it and organize it—frankly, I had all the problems I could handle, and I was not enthusiastic about the prospect of adding to both our operating and our financing burdens the problem of trying to blow the system up to a considerably greater capacity to get into the California market.

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Q. Weren't you concerned that Mr. Fish might enter into some binding arrangement and— A. Well, Mr. Bennett, I was satisfied in my mind on two things: First, that there was no economic feasibility to the project he was discussing with the Edison Company. I just did not think it would bear fruit. Now I would have been a very surprised young man if all the pictures had been put together, and I frankly do not know what I would have done about it. And I have always had a very confident feeling that Pacific Gas and Electric Company did not want to buy gas from Pacific Northwest.

Q. Is your view the same with respect to Edison? A. Well, I did not think that the Edison Company had any real preconceived opposition at all, Mr. Bennett. I just thought that that could not jell because of the sheer arithmetic of the project, frankly. I just thought it had entirely too many obstacles, economic, regulatory and otherwise.

Q. Did you and Mr. Fish learn that Mr. Kayser had talked to Mr. Quinton at about that time? A. Well, I certainly did not, Mr. Bennett.

Q. Mr. Fish never told you anything like that? A. Well I do not recall it if he did. I do not think he did.

Q. Well didn't you yourself at one time, in a conversation

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in California, make reference to the opposition of Mr. Kayser to your entry into the California market? A. Not to my knowledge, no, sir.

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Q. At one time Pacific owned 6,664,000 common shares of Northwest Production Corporation. Do you happen to know whether that number of shares has been diminished

in any respect? A. No, sir. I believe they own the same number of shares today.

Q. Does that stock have a market value? A. Yes, sir.

Q. I myself do not know what it is, but at one time it was 6.5, at least, in 1956. You do not happen to know the market value today, do you? A. Well, I do not exactly, Mr. Bennett, but it is in the order of maybe 3.5 or 3.4, or something of that sort.

Q. Now, again, is the retention of the Northwest Production Corporation stock necessary so far as Pacific Northwest Pipeline Corporation is concerned, that is, necessary to its operation as a Pipeline Corporation? A. No, Mr. Bennett. I do not think it is.

Q. And again that stock could be sold, could it not,

if it were necessary to raise capital? A. At some price, yes, sir.

Q. At a price greater than that which you originally paid for it? A. Mr. Bennett, that is an awful lot of stock. I do not know what would happen if you were to sell it. In fact, I do not think, as a practical point of view, you would. I think the block of stock and the circumstances surrounding the company is such that it would be rather foolhardy to sell it, frankly.

Q. Well now, do you recall that in the proxy statement of the El Paso Natural Gas Company dated November 26, 1956, which is Exhibit 3, that it was represented to the stockholders of that corporation as having a value of $43,316,000? A. In market value?

Q. Yes, sir. A. Yes, sir. I think that was a simple statement of correct fact.

Q. Are you saying now, today, that the value is very much less than that? A. The market value is, Mr. Bennett. Yes.

Presiding Examiner: Did you say is or is not? The market value is or is not the same today?

Was that not your question?

Mr. Bennett: His answer was that it was less, as I

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recall.

By Mr. Bennett:

Q. Is that not so, Mr. Silloway? A. That is right.

Presiding Examiner: The market value is smaller today; is that right?

Mr. Bennett: Yes, sir.

The Witness: Substantially less.

By Mr. Bennett:

Q. It is about half as much, is it not? A. Yes.

Q. It is a little over $20 million as of today, if the market price is around $3, is that not so? A. Yes, sir.

Q. Now, the El Paso Corporation made an advance of $15 million in 1957 to the Pacific Northwest Company; is that correct? A. Yes, sir. That is correct.

Q. And in exchange for that advance did it take back Pacific stock? A. No, that was in the form of a note, Mr. Bennett, as I recall it, a subordinate income note.

Q. It is still in the form of a note, is it? A. Yes, sir, I am confident no change has been made in that.

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Q. Now, Mr. Silloway, you testified in your direct examination that El Paso has the resources—at page 147 of the reporter's transcript—and what you testified was that El Paso could more aggressively develop the markets in the Rocky Mountain area and in the Pacific Northwest than could Pacific.

Now, what are the reasons which prompted you to state that El Paso would be more aggressive than Pacific in this

particular field of activity? A. Well, not that they would be, but they could be, Mr. Bennett. And by that I meant that El Paso would have the financial means to support drilling programs and to encourage drilling programs by either direct financial assistance whereby additional favorable purchase contracts, and in particular, by getting into a field and laying in there and taking the gas at an earlier date than would be the case if Pacific was standing alone.

Q. Well now, with reference to the markets in those areas, is it your testimony that El Paso would be more aggressive in developing the markets? A. Well now, what market areas do you mean, Mr. Bennett?

Q. The Rocky Mountain area and the Pacific Northwest area. A. Well, are we referring again to page 147 of my direct testimony?

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Q. Yes, sir. Lines 4 and 5. A. Yes. What I had in mind there was, Mr. Bennett, that El Paso would, in all probability, feel that it could make some extensions of sales laterals in the Pacific Northwest sooner than would Pacific Northwest by itself.

I also, frankly, have had in the back of my mind that probably El Paso would feel free to do more advertising and sales promotion than we have had the resources to do.

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Q. Now, Mr. Silloway, on page 148 of your direct

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testimony, particularly lines 9 and 10 thereof, you referred to the fact that you felt very strongly that by means of the merger the period of years which would be necessary to build into the Pacific System sufficient additional sales pull and revenues to provide lower unit costs and adequate

earnings through the normal development of Pacific's load alone can be very materially shortened.

Now what period of years did you have in mind in terms of numbers to make you feel so strongly about that? A. Well, it is awfully hard to be precise, Mr. Bennett. We have been disappointed in the quantity of sales and delivery of gas into the markets that Pacific was originally certificated to serve. That market has built up very slowly. I think that probably we are facing up there maybe another four or five years of relatively slow development to get to the point where the volume of sales is more consistent with that which was originally programmed. Now how much El Paso would shorten that I just do not know, but I feel very confident that it would be shortened.

Q. Now what are these lower unit costs you are talking about in your testimony there? A. Well, what I am talking about there, Mr. Bennett, is more fully utilizing the capacity in the existing Pacific System, loading it as fully as possible so that the cost incident to each individual Mcf of gas will be lower.

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The Witness: Going back again to my testimony, Mr. Bennett, I have just said categorically that I think El Paso can develop these markets, actual and potential, up in the Pacific Northwest to better advantage than Pacific can standing alone. And as I previously said, I had clearly in mind that they would be more aggressive in their sales promotion activities and would be able to do something up there that Pacific has not been able to do to promote the sale of gas.

I also think that there are other areas up there into which sales laterals can be built that Pacific probably would not feel that it could undertake but which we think, nevertheless—I think the territories would respond to the intro-

duction of natural gas to the benefit of the Pacific System. I have in mind one area in particular, that whole Columbia Basin area.

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Q. Now, Mr. Silloway, at Page 129 of the reporter's transcript you testified with reference to a loss for Pacific in the year 1958, that it was going to be in the order of a million and a half dollars. Do you recall that? A. Yes, I do, Mr .Bennett.

Q. And now directing your attention to Exhibit 369, particularly Page 16 thereof, I will ask you to note that there is shown for the year here on 1958 a loss in the amount of $560,269. Is that correct? A. Just let me look at this a second, Mr. Bennett, please.

Q. Yes, sir.

Presiding Examiner: You identify that by number, but what is it, for my information? That exhibit?

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Mr. Bennett: You want the page number——

Presiding Examiner: No, what is it entitled so I will know what you are talking about.

Mr. Bennett: It is entitled "Pacific Northwest Pipeline Corporation—Financing".

Presiding Examiner: And it is one of the exhibits introduced in support of the case in chief?

Mr. Bennett: Yes, sir.

Presiding Examiner: All right, that is what I wanted to know.

Thank you, Mr. Bennett. Proceed.

By Mr. Bennett:

Q. Now, Mr. Silloway, have you noted the figure of $560,000 there, net loss? A. Yes, I see it there, Mr. Ben-

nett. It does not, as you point out, jibe with my testimony that I thought that Pacific would show a loss of about a million and a half dollars in 1958.

Now for the first eight months, that is through August 31, Pacific's actual loss was about $1,900,000 in round numbers.

I have not yet seen in detail the September figures, but I would think that probably a somewhat smaller loss than had been achieved in earlier months would have been realized in the month of September. Now there may be—on any monthly income statement, as you know, there can be some adjustments from one

month to the other. But I feel confident that in the months of October, November and December that the system will have profits, and that the effect of that will be to reduce the loss which were shown at the end of August of, roughly, $1,900,000, to some lesser amount. Now whether that be $1,400,000 or $1 million 5—obviously, at the time I gave this testimony, Mr. Bennett, I was merely expressing an opinion. And I still think that that is a pretty good point of view.

Q. Now when you say you think that is a pretty good point of view, you mean that your estimate of the loss as given in your direct testimony is? A. Yes, I think it is.

Q. In other words, that opinion you gave as to the loss for the year 1958 is more apt to be correct than the figure set forth on Exhibit 369? A. I think so, yes, Mr. Bennett. Now if this means what I think it does, this was prepared and was filed on February 28, of '58, so that I should have a more accurate point of view since I expressed one that is based on later information.

Q. Your information is based on actual experience, isn't it? A. Based on actual experience through the month of

August, Mr. Bennett, and then just my own thinking as to what the results for the remainder of the year would show.

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Q. Do you have any opinion as to 1959 earnings, independent of that exhibit which is before you? A. Well I do have, Mr. Bennett, yes. Just taking a look

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at Pacific's existing markets, the markets that it has been certificated to serve, and projecting 1958 under what you would assume to be the business conditions that might attain in 1959, I think that Pacific will have better results in 1959 than it had in 1958.

Now some recent projections have been prepared showing a profit before preferred dividends of approximately $560,000 as compared with preferred dividend requirements of about $1,100,000 or $1,200,000 in round numbers. Now that projection is predicated upon average daily volume of 581,000,000 feet per day. Since seeing those figures I have thought about them somewhat, and I am inclined to feel, Mr. Bennett, that maybe those volume assumptions are a little bit on the high side. I hope that they are not, but I am inclined to feel that perhaps they are. I am not convinced that the market will grow that much in 1959.

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By Mr. Furbush:

Q. Mr. Silloway, will you direct your attention to the occasion when you accompanied Mr. Fish on your excursion to California in hope of selling gas to some of the California companies?

As I recall your testimony yesterday, you said that you were not too well prepared for that, inasmuch as you had

many problems of your own on the Pacific Northwest system at that time. Is that correct? A. I do not know just exactly what you mean by not being well prepared for it.

Q. Well, you did not give it too much thought, you did not consider it to be very, well, a very important trip? A. I said that I did not feel that we were going to be able to do business with the Pacific Gas and Electric Company.

Q. And you also said that you had many problems of your own on the system at that time with Pacific Northwest? A. Yes, I did say that.

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Q. What were the problems that were confronting you at that time? I mean your major problems? A. Well, thinking back to the date, sir, it was in the fall of 1956 and we did not yet have the system fully completed. We were attempting to get it finished and get our bills paid and get to the point where we could deliver gas. We were moving people from Houston to Salt Lake City, and we were trying to get staffed and organized to go fully into business. We just had a lot of operating problems at that particular time.

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Q. You say you were quite confident that you would not be able to sell the gas to Pacific Gas and Electric Company.

Can you please state the reason for that confidence? A. Well, I guess it is just, maybe, just a general impression that I had that was founded out of conversation with a variety of people that P G & E did not want to buy gas from Pacific.

Q. Was it your understanding that they thought that Pacific Northwest was an uneconomic project, and they did not want to be tied into that? Was that the general purport of the information that you had? A. Well, I have

heard it said, and I think from sources that I would consider to be reliable, that the P G & E people did have some misgivings about the soundness of the Pacific system, particularly in the early years.

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By Mr. Kurtz:

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1874

Q. Now you are talking about Pacific as a separate corporation and certain losses that Pacific was receiving and in your opinion, relating to the financing, that difficulty of financing if Pacific was a separate corporation. Now

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assuming under the same premise that you were talking about, what income, utility income, would Pacific have to receive to be able to finance upon reasonable terms? A. Well, I cannot put it in terms of dollars, Mr. Kurtz, but Pacific would have to have a coverage of fixed charges.

Q. Fixed charges. What else? A. And it would also have to have a coverage of combined debt service, that is, combined interest and principal before depreciation.

Q. All right. A. My recollection is that it would need one and a half times the latter, and two and a quarter times the former. I think those are provisions in the mortgage, Mr. Kurtz.

Q. Now if those were complied with, then you think that Pacific could finance upon securities financing under reasonable terms, is that what you are saying? A. Well, those would be earnings, those are the minimums, Mr. Kurtz, that would be necessary, and I would think that Pacific, looking at it now, with its rather unsatisfactory past record of earnings, would have difficulty financing

with minimums. I probably could do it, but it certainly would not be the kind of a credit that would get the best rate.

Q. All right, what else would they have to have to make the financing on reasonable terms, in your opinion? A. Well, I would say, Mr. Kurtz, just some margin over

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those minimals would probably make it possible.

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1886

By Mr. Threadgill:

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1888

Q. Subsequently you concluded that your operating costs, plus depreciation and return on those facilities, considerably exceeded five or six cents per Mcf; is that correct? A. Well, yes, sir, the individual wells in the San Juan Basin and the acreage that we are referring to turned out to be smaller wells than had been originally projected, which meant to recover a given quantity of gas it was necessary to go to more wells, and, therefore, more gathering and the capital cost and the operating expenses that would go with more facilities. But that information was not available at that time.

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Cross-Examination

By Mr. Kurtz:

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Q. What I'm getting at is: You have gas from the Permian Basin. You have it from Canada. You have it from

some fields along the Pacific line. You have it from the San Juan Basin. Now, in determining—in meeting your market demand, do you pull upon the Permian Basin and the Canadian gas, for example, and take the swings from your other sources? A. Well, of course, to this extent out of the Permian Basin, Mr. Kurtz: The residue gas, of which we take about a billion one to three a day during normal operating days, has to be produced every day, because we don't flare it, and we have no provision in the contract to flare it. So we first see that we take all of the residue gas that is available. From that point on, we can pretty well arrange the makeup or the balance that is required from several sources, and, depending upon the standing of the dry gas field in the particular area that it is in, I think that pretty well answers

1911

the question of where we are going to get the rest of the gas that we need to fulfill our entire load. We keep the lines out of the Permian Basin loaded to the extent that we do take all of the residue gas, when it is available, that we are connected to.

However, that residue gas doesn't necessarily have to go down the Southern system. Part of it can go over the cross-over line from Plains to Gallup, if we wish to send it that way.

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1920

Hugh Steen

resumed the stand and testified further as follows:

Cross-Examination—resumed

By Mr. Kurtz:

Q. Mr. Steen, am I correct that you are the one that negotiated for the gas purchases out of the Aneth Field? A. Yes, sir, that is correct.

Q. If I understand the situation there correctly, your initial offer for that gas—was it 14 cents? A. That is correct; yes, sir.

Q. And summing it up, as I understand it, there is competition for the purchase of that gas between the El Paso company and the Transwestern Pipeline Company, that was proposing to take gas out of there, and you had to pay 20 cents for that gas as a result of that competition; is that correct? A. Mr. Kurtz, we had to pay 20 cents for the gas.

Q. All right. The reason you had to pay 20 cents, was it because of the competition of Trans-Western? Isn't that right?

A. We tried to buy it for all the scales up and down above fourteen cents, but we could never get the producers to sell it to us until we did offer them the 20 cents.

Q. And you knew that there was a competing proposal, didn't you? A. Yes, I sure did. I found out about it when I was trying to buy the gas. I did not know it prior to that.

Q. And were you informed at that time as to the price the competitor was paying? A. Mr. Kurtz, my information, when I heard that they were trying to buy the gas, my information was that they were offering 17 cents. I did not know that they offered 20 cents until I saw a contract that they had signed with one of the producers.

Q. Superior Oil Company? A. That is correct; yes, sir.

Q. And then you offered 20 cents, likewise? A. Well, I had already offered 20 cents before I saw that contract; yes, sir.

Q. You knew—whatever price it was, you knew you were not buying it; and so, finally, you offered 20 cents? A. That is correct; yes, sir.

Q. And it was accepted, and the companies accepted the 20-cent price? A. Yes, sir.

1922

Q. And you had another advantage over a pipeline such as proposing to take gas from an area such as the Trans-Western in that you could take the deliveries faster than any new line to be built; isn't that right? A. I think that is a fair statement.

Q. You were also faced in that area—at least there was mentioned to you, a proposal by The Texas Company to build a pipeline to California; isn't that right? A. Yes, sir; in my negotiation with The Texas Company they advised that they were looking at several other propositions, and I believe he told me one of them was that he was looking at the California market, but I am not absolutely sure, but I understood that he was.

Q. That is the only place the gas could go, isn't it? A. Well——

Q. Within reason? A. Well, Mr. Kurtz, I believe it could go other directions. I think it could go to Colorado Interstate, and possibly by running a pipeline from—I am sure it is not over—I do not know exactly how far it is—but it is in the range of two hundred to three hundred miles—it could be connected to the Dumas area. Maybe it is four hundred miles. I have it on a schedule, but I do not have it before me. It could be connected to any of the markets going to the east.

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Q. Let me ask you something else. At this time is there much exploration work being done in the San Juan Basin other than El Paso?

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A. Yes, sir.

Q. By whom? A. Well, Mr. Kurtz, most of the majors are in there in some degree. There are any number of independent producers that—I cannot recall all of them—have acreage in or about the San Juan Basin.

Q. Well, are there drilling operations going on by the independents at this time? A. To some extent. However, the independents are focusing most of their attention on the proven area, to the Mesa Verde, in order to get the income as quickly as possible. I do not know of any——

Q. Well, the best part of the field at the present time is pretty well drilled up, so far as the Mesa Verde formation is concerned; is that not your understanding? A. The Blanco Area, which I consider to be one of the better parts of the field, is pretty well drilled up on 320 acre spacing. Now, they have not touched the 160 yet.

Q. Pardon? A. They have not touched the 160 spacing which eventually will have to be drilled one of these days.

1930

Q. Well your producer has the same problems that you have relating to the drilling of dry holes and so forth, has he not? A. To some extent, yes, sir. I do not think he would step out as far as we would in some instances to prove things. Now the majors might, but the independents are more conservative. They pretty well stay inside the proven area if possible.

Q. Now as I understand it, the Trans-Western has an application that extends from the Permian Basin across New Mexico, I mean, out of Texas across New Mexico, Arizona to the California-Arizona border. Is that about right? A. That is my understanding, yes, sir. I have never looked at their application.

Q. Well you know what volume they are proposing to

transport to California, don't you? A. 300 million is my understanding, yes, sir.

Q. And are you aware of the prices that they are offering for gas in the Permian Basin? A. Yes, sir, to some extent I am aware what I have heard they are. I have never seen one of the contracts where they actually offered it.

Q. Have you checked the application of Trans-Western here on file with the Commission, or had it checked by anyone in your organization, as to prices that they were paying for gas?

1931

A. Yes, sir, we have checked. I do not know, I think I can get it in a few minutes, but offhand I am not positive what prices they are paying because I believe they are paying somewhat different prices in different areas.

Q. But what I am interested in trying to find out, is it any concern of yours in securing additional supplies for the El Paso system in the Permian Basin that Trans-Western is also bidding for gas? Does it bother you any? A. Yes, sir.

Q. Why? A. Because the reason it bothers me is that we need gas continually. We have to buy the gas that we get, of course, and if anyone else comes in there and raises the price of gas, I see very little opportunity for us to buy that gas at any cheaper price.

Q. Is there anything else you want to add to it? A. No, sir.

Q. My notes show that Trans-Western is offering a price at the Keystone plant in Winkler County, Texas, of 21.8 cents. Does that sound familiar to you? A. That is what I had heard they are offering, yes, something in excess of 21 cents.

Q. And in that same county you are paying 11 cents,

aren't you, plus 1 cent escalation in 1959? A. That is correct.

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Q. All right, let me ask you this: If you wanted the gas, for whatever reason it may be that you desire to purchase the gas, do you think you could purchase gas in that county at any figure under 21.8 cents? A. Mr. Kurtz, if any pipeline company that had a reasonable chance of being constructed, or one that is already constructed, we will say, went into a field and were offering 18, 21 or 45 cents to everyone in the vicinity, I cannot tell you that they are going to sell me any gas any cheaper than what the competition is offering.

1933

Q. Well if I were the purchaser, I would not sell it to you cheaper. I just wondered if they were different from my feelings. A. No, sir, they are not at all different from you. In fact, I think they are a little worse than you are.

Mr. Kurtz, there is only one thing that I might qualify. There might be producers that had wells that were being drained, or there might be producers that had leases that were expiring that might sell me the gas for the existing contracting price of the older contracts in order to save a lease or prevent drainage on a small block of gas, or something of that nature. I would not say that it would not be possible to buy small segments of gas from time to time at El Paso's existing contracts.

Q. If that is all you could buy, would you be out trying to buy gas in the Permian Basin? A. Well, we would not turn down those little blocks if we had our facilities in the vicinity, no, sir. But if we had to build a pipeline on it, or build our reserves to a great extent on it, I do not think we would be working hard on it.

(1933)

Q. I have a note here that in Lea County, New Mexico the Warren monument plant is offering a price at 18 cents by Trans-Western. Does that sound very familiar to you? A. I had not heard that. I had heard that one or two of the other carbon plants, one or two spots were being sold to

1934

carbon black plants under contracts of varying lengths, that he had offered as high as 16 cents. I had not heard, Mr. Kurtz, that they had offered 18 cents.

Q. Well the notes that I have here on the Trans-Western prices do vary. A. Yes.

1935

Q. Well, my notations—Would you accept the prices subject to your check, that I am going to give you as to Trans-Western? A. Yes.

Q. In the Panhandle area, from the British-American Oil Producing Company, the price they are paying is 23 cents, and in the Crawar Field, in the Counties of Ward and Crane, Texas, from the British-American Oil Producing Company, the price of 16 cents. A. How much?

Q. Sixteen cents.

And from Curtis R. Inman, in the Worsham Field of Reeves County, Texas, 16 cents.

The Richardson & Bass, and others, from the west Texas area, in the Counties of Winkler, Crane, Ward, and Reeves 21.8 cents.

From the Gulf Oil Corporation in the Panhandle area, in the Counties of Dallam, Hartley, Sherman, Hansford, Ochiltree, Lipscomb, Hemphill, Roberts, Texas, a price of 23 cents. And from the Gulf Oil Corporation in Pecos County, Texas, 16 cents.

From G. H. Vaughn, Jr., and others, from Ellis County, Oklahoma, the price of 23 cents.

The Gulf Oil Corporation in the Panhandle area, from

Cimarron, Texas; Beaver, Harper, Woodward, and Ellis, Oklahoma,

1936

23 cents.

Cities Service Gas Company in the Hugoton Field, 21 cents.

The Superior Oil Company in Lipscomb County, Texas, 23 cents.

Magnolia Petroleum Company in Lipscomb and Hemphill, Texas, the price of 23 cents. Magnolia Petroleum Company in the County of Ellis, Oklahoma, 23 cents. Magnolia Petroleum Company in the Rio Arriba and Sandoval County, New Mexico, 17 cents.

The Hunt Oil Company, Ellis County, Oklahoma, 23 cents.

From the Gulf Oil Corporation in Crane County, Texas, 16 cents. Gulf Oil Corporation in Pecos County, Texas, 12 cents. Gulf Oil Corporation in Reeves County, Texas 16 cents.

The Pure Oil Company in Reeves, Texas, 16 cents.

Monsanto Chemical Company, in Reeves, Texas, 16 cents.

The Pan-American Petroleum Corporation in Crane and Ward Counties, Texas, 16 cents.

Sun Oil Company, in the Counties of Hemphill, Hutchinson, Lipscomb, Ochiltree, and Roberts, Texas, 23 cents.

Humble Oil and Refining Company in Roberts, Texas, 23 cents.

Union Oil Company of California in Eddy County, Texas, —New Mexico—20 cents.

Warren Petroleum Corporation, Wheeler, Texas, 23 cents. Warren Petroleum Corporation in Lea County, New Mexico, 18 cents.

Now, all of these purchases that I have called off to you are within the areas in which you likewise are purchasing gas;

1937

are they not? A. Generally, yes. There might be one or two exceptions but, generally speaking, that is correct.

Q. Now, the effect of such contracts, what will that have upon your purchase cost in the Permian Basin? A. It is going to make it rough, but that really makes our Thistle project look like a good thing; doesn't it, Mr. Kurtz? On that price.

Q. Well, let's just stick to the Permian for a little bit. We will get over to that.

What I am interested in, you have this project of Trans-Western, it is in your area, taking gas out of the same area, now what is it going to do to your costs of gas in that area? A. Well, Mr. Kurtz, of course, I do not know what Trans-Western can do or cannot do, but it will make it very difficult for us to buy gas; that is all I can tell you, at prices below what is being offered by any bona fide company.

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1944

Q. I mean, what I have in mind is, would it be different if Pacific was not operated as a subsidiary, but was actually independent of El Paso? Would the saving have been any different than your estimate?

1945

A. Mr. Kurtz, maybe I was mistaken. The study that I made was Pacific's operation at this time, as it is now being operated—or will be in the near future. There are a few more people shown on the saving than Pacific actually has at this time. But we gave it an upgrading to some extent in personnel as far as numbers are concerned. Then we made the study as to what it would cost

us in our estimation to operate Pacific as an integrated or merged company, yes, sir.

Q. And you came up with a saving of $1,115,000 per year? A. That is right, yes, sir.

Q. And do you consider the expenses of Pacific as being legitimate expenses? A. At this time?

Q. Yes. A. Yes, sir, I surely do. I think it is being operated in a very efficient manner at this time.

Q. In other words, what you are saying is that if you have one company doing the transportation from the source of supply to market, you have a cheaper operation than if you had two companies doing it; is that what you are saying? A. I believe that is right, yes, sir.

. . . . . .

1946

A. What I am saying is that the way Pacific is being operated, that there is outright duplication of services, of

1947

personnel.

Q. In what departments? A. In nearly all of the departments with the exception of the field operations and main operations.

Q. All right, you name the departments. A. All right, sir. There is a duplication in what Pacific would call the Administrative Department; Public Relations; Aviation; Sales and Rates; Gas Purchases;——

Q. Wait a minute. Sales and Rate? A. Yes.

Q. All right. A. In the Transmission offices in so far as the supervisory personnel is concerned; Gas Measurement; Engineering; Communication; Employee Relations; Purchasing; Controller; Accounting——

Q. What? A. Accounting. Did I name that?

Q. No. A. Production; Leasing or Land; in the officers, there is duplication there.

Q. General officers? A. Yes, sir.

Q. All right. A. I think that covers most of it.

1969

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Q. Do you know how Pacific is planning on moving all of its gas? Have you made a study of it? A. Pacific Northwest?

Q. Yes. A. Yes, sir.

Q. How many times have you been up studying it? A. How many times what?

Q. Studying it, the operations of Pacific? How many times?

Did you go to Salt Lake to study it? A. I have only been up there one time since September 1, or about September 1.

I have been there, I think, only one time prior to that. As far as studying the operations while I was up there, I did not do a great deal except through my associates that did estimate the studies and that did go up there, that have been in the business for many years, and associated with that.

Q. In other words, you had someone else make the study for you, you went over it and you decided, and you took the responsibility for the study; is that the way it works? A. Yes, sir; we discussed the study at length with all of the department heads.

Q. Including Mr. Norwood?

1970

A. Including Mr. who?

Q. Mr. Norwood of El Paso. A. Are you talking about the savings of this?

Q. Yes, that is what we are talking about, the $1,115,000. Did you say that you had discussed it with him? A. Yes, sir, we discussed it with him to this extent:

We discussed with his department, and Mr. Norwood was in on it, how many people we would need to take over the functions that are being done by a similar department in Pacific. We did that with each of the section supervisors in our company. And those numbers that we came up with on the saving were furnished by those supervisors.

Q. After you came up with this total figure of $1,115,000 I suppose you let everyone in El Paso know of the results of your study? A. I am sure we let all of the department heads concerned know what it was, Mr. Kurtz. Other than that, I do not know that we discussed it with anyone.

Q. But you let all the department heads know of the results of your study, did you not? A. Yes, sir.

Q. And at what period of time did you make the study? A. Mr. Kurtz, we made the study—I cannot give you the date, but it was prior to the merger filing.

Q. Prior to the merger filing?

1981

A. Yes, sir.

Q. Some time prior thereto? A. Yes, sir, because the figures used in the merger filing were, to a great extent, the result of the study. They were refined a little bit after that, but generally speaking, they were.

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1985

By Mr. Bennett:

Q. Mr. Steen, at page 158 of your testimony, wherein you stated that:

"I estimate savings."

you had reference to this study——

A. Yes, Mr. Bennett.

1986

Q. And you yourself actually made no estimates, is that correct? A. In conjunction with the others; yes, sir. I sponsored it and checked it thoroughly, yes, sir.

Q. Well, what I am asking is this: Did you make the estimates yourself, or what did you do with reference to that so-called study? A. I called all of our supervisors in several times and told them that in the merger there should be savings that we wished to point out, and asked them in each of their departments to go over the work involved, as far as Pacific's adding to their work, Pacific's operation adding to their work, and to give me their best estimate on the number of people additional they would require to carry out those responsibilities.

Q. How many people were there present? How many supervisors? A. I would just judge—I don't know that they were all in there right together, but I am sure I talked to eight or ten people over a period of a week there, Mr. Bennett.

Q. And when was this meeting held? A. It was prior to the merger application. I can't give you—prior to the filing of the merger application, the original one.

Q. Were these all El Paso people?

1987

A. Oh yes, yes.

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Q. When was that study prepared? A. It was prepared —the study was prepared after we had talked this thing over, and I used the general dollar amounts that we came up with—they are not exactly correct, they are generally correct—in my testimony. This study was prepared subsequent to that.

Q. Now, what I am asking is this: That merger savings statement, when was that document prepared? A. The merger filing?

Q. The document which is in front of you there. When was that document prepared?

What is the title of that document? A. It is just "Estimated Merger Savings", a merger savings estimate.

Q. Now, when was that prepared? A. It was prepared—I don't know the exact date, but it was subsequent to our meetings and the general work papers on it were prepared after I testified here, but it had already

1963

been worked up. It just had to be refined and put down on a piece of paper, here.

Q. But that particular document was put into the present form after your direct testimony in this matter? A. In the present form, that is correct, because Mr. Kurtz asked in the testimony that I give him a copy of it.

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1962

Q. What specific jobs are going to be abolished to accomplish a saving of $100,000? In executive salaries, of course. A. Well, I used the President's salary, which has since been abolished; the expenses and directors' expenses, and fee, and that just about does it, in my estimation, the $100,000, Mr. Bennett.

Q. What was Mr. Silloway's—you mean Mr. Silloway's job has been abolished? A. Yes, sir. Mr. Kayser is now—he is either the President or the Chairman of the Board or both; I'm not sure.

Q. Is he receiving any compensation for that office? A. No, sir, not at this time.

Q. Well, is he going to receive some at any future time? A. Not to my knowledge, he isn't. If the companies merge, he will not. If the company isn't merged, I don't know what the outcome will be.

(1962)

Q. What was Mr. Silloway's salary? A. I'm almost sure this is right, Mr. Bennett. I feel

1963

sure that it was $65,000 a year.

Q. Now, what constitutes the balance between the $65,000 and the remainder of the $100,000? A. Well, there is—as I say, directors' fees and expenses.

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1967

By Mr. Bennett:

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1969

Q. Now, did you hear Mr. Kayser testify that he visited the Pacific Northwest system, and he told the employees that there was a place in the organization for everybody who was presently on the Pacific payroll? A. I was with Mr. Kayser when he made the visit.

Q. What did he say with reference to the retention of Pacific Northwest employees? A. As I remember it, Mr. Bennett, he told the employees, naturally, this thing has been rather delicate for six or seven months. I think you will appreciate that, when those employees didn't know whether the company was to be merged, whether it was to be operated as a separate company, whether it was to be disposed of. They didn't know just where they stood, and they were anxious and upset about the whole situation. When Mr. Silloway, just prior to his leaving, Mr. Kayser and I made a trip up to the Salt Lake City office of Pacific Northwest. The employees of the office group—I don't know how many field employees were at the meetings, but I don't imagine very many were—they came into the big halls they have there, and we had two

meetings with them. Mr. Kayser told them if they wanted to work, if they really wanted to stay in there and pitch, that if we merged the thing, we were certainly going to try to take care of them. If somebody else ended up with the

1970

company, they would be required, possibly, for the operation of the company that might succeed El Paso.

Q. Well, wasn't the purpose of that address to the employees to reassure them that they would not have to worry about employment? A. That is correct. The purpose of the address was to tell them that El Paso was—if they wanted to work—was going to try to make jobs available for them.

Q. Well, what does that mean, now? Does it mean you are going to keep all the former employees, or it doesn't? A. It means, Mr. Bennett, I think, that we'll be able to replace all of them that wish to work and make as good hands if the merger goes through with El Paso. I'll tell you the ways, if you care for me to, how we intend to do that.

Q. Perhaps you answered it, but I didn't seem to understand it. Am I to gather that all of the employees of Pacific are to be retained because of what Mr. Kayser told them, or that there is some other plan for separating some of them from employment? A. The employees will be offered jobs with El Paso. I can tell you how they will be offered jobs if you wish for me to. I would like to.

Q. You are anxious to tell me? A. I surely am.

Q. Then go ahead.

1971

A. Thank you, Mr. Bennett.

Well, the El Paso company between 1955 and 1956, due to the expansion that this company has had—we added to our payroll 483 people. Between 1956 and 1957, we

added to the payroll 818 people. Between 1957 and so far into 1958, we have added to the payroll 265 people. The total number of people employed by El Paso, not counting Pacific at this time, is right at 5179 people. The turnover per year on these employees amounts to roughly five or six per cent.

Take five per cent of the 5100 and you have something over 250 people a year that we have to replace.

Now, in this study that we were discussing on savings, we show that 166 people would be saved as far as Pacific is concerned. Off that 166 people, with the growth and expansion of El Paso continuing such as it is with what we hope will be the conclusion, the desired conclusion of the Thistle Project, with the additional gas we have applied for to PG and E, with the new plant that we'll have to build, we feel that in a relatively short time we'll have jobs for these 166 people on the El Paso system that we would have to hire whether the merger took place or didn't take place.

We feel that although maybe tomorrow or the next day each of the qualifications these people have will not fit into exactly the job that we have open, in a matter of a short time we'll be able to place all of them that wish to remain with

El Paso on that job.

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Q. It is presently undermanned? A. That is right. They are having trouble keeping up their work with the people they have. In all of the testimony Mr. Silloway gave, he said that they had been operating and might have to continue operating for another year or two, a little bit short, he thought.

Q. Are you going to have to hire more people in the

Accounting Department in the next few years, then? A. I can't answer that until I have a little better feel of it, Mr. Bennett, other than standing on his testimony that he felt the thing should be built up.

Q. I'm asking you about your testimony that there would be a savings in the Accounting Department in your study which you have testified about. A I think there will be if the properties are merged.

Q. From your study, don't you know? A. Oh, yes.

Q. Then tell us what you know. A. There will be a saving in the Accounting Department. Do you want to know the amount?

Q. No, sir, I want to know—you have told us now that the Accounting Department is going to require more people there. A. If the company is not merged.

Q. Well, did not Mr. Silloway say it needed more people, even before the acquisition? A. He said—Mr. Silloway, as I remember his testimony, said that he felt they were working shorthanded in nearly all of the departments.

Q. Yes, and you just said you were going to have to hire more people in that department, didn't you? A. I was basing my statement on his testimony. He said

he thought they might go ahead for two more years, I believe he said, but it was a rather imposing, trying condition upon the employees.

Q. Assuming that he is correct and you do hire more people, how is that going to effect this saving of $150,000 which you testified would occur?

Is it going to increase it, or—— A. If they hired more people prior to our merging the company, we wouldn't save as much as I show, because my estimates are made

against what they now have, what they are now spending in the Accounting Department.

Q. And assuming Mr. Silloway is correct, then this saving would be accomplished, really, by leaving the Accounting Department undermanned or overworked, whatever you choose to call it. Isn't that so? A. No, sir, because I use the amount of people there to start my saving from.

Q. But you are going to hire additional people in the department, are you not? A. Oh, no; if it is merged, you mean?

Q. Yes, sir. A. No, if it is merged, we are going to eliminate a number of people by combining the Pacific Accounting Department with the El Paso Accounting Department. We'll save enough people to equal the $150,000 or thereabouts.

1975

Presiding Examiner: These savings, as I understand the testimony, are not going to be accomplished unless there be a merger. So pending the merger, if one does occur—pending that time—there is going to be no change in the employees of Pacific.

Of course, Mr. Kayser has taken over the work as President that was done by Mr. Silloway when he resigned or left the first of September.

1976

But we have got to talk about two savings, before and after merger, as far as saving is concerned, because a saving is not going to occur unless there is a merger.

If there be no merger, you go back to where you were. There will be no saving. That is the way I understand his testimony. I don't think any other claim will be made,

except that these savings will be effected by means of the merger.

Failing the merger, there will be no savings.

1991

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By Mr. Furbush:

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1992

Q. Now, the difficulty I have is understanding just why these savings cannot be accomplished without the merger. Why can't you just transfer those functions to the employees of El Paso without the merger taking place? A. Well——

Q. I mean, it is not an unusual situation to have that done.

Presiding Examiner: Do you mean, then, with Pacific operating its affairs as a subsidiary of El Paso?

Mr. Furbush: Yes.

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Operating it as a subsidiary, and this is the one that I get worked up about, anything that I do in that field or along that main line, as far as mixing the gas streams or taking some over here, exchanging it over there, I have to go to the Federal Power Commission and get approval to do that, just like I was making that deal with some completely foreign company.

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Arnold R. La Force

was recalled as a witness and, having previously been duly sworn, was examined and testified as follows:

Presiding Examiner: Are you ready to proceed, Mr. Kurtz, with Mr. La Force?

Mr. Kurtz: Yes.

Cross-Examination

By Mr. Kurtz:

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Q. So far as you are concerned, as I gather from what you have just said, you were in favor of the acquisition because of the attachment of additional reserves; is that right? A. Yes, and because also I believed that the terms of the acquisition were reasonable and fair terms.

Q. Let's see; we have the attachment of reserves and the terms of the acquisition were fair and reasonable. Any other reasons? A. Yes. I would say that other than just the simple attachment of reserves, to my knowledge, before I was with El Paso, there were many ways in which El Paso and Pacific

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were very closely and very intimately connected with respect to their pipeline systems.

As you developed, I think, in the direct testimony of many witnesses, there have been previous discussions with respect to the acquisition of Pacific Northwest.

Likewise, they were drawing gas from the San Juan Basin; there were many ways in which, if you could combine them to achieve an integrated and flexible operating system, that you would have a very sound pipeline system,

with the ability to serve customers at a low cost, as opposed to two separate operations.

Q. Well, you have covered quite a little territory there, but I am trying to determine just what it is that you have been saying. Is this it?

Your third reason is that you could serve the customers at a low cost. Is that what you are saying? A. No. My first reason——

Q. I got the first two; attachment of the reserves, the terms of the agreement fair and reasonable. Now, this third one—are you saying that you serve the customers cheaper by reason of the merger than you could as separate corporations? Is that what you re saying? A. Yes.

Q. And at that time—and I'm talking of your own thinking only—at that time, did you have any figure in mind

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as to how you could accomplish this third means by reason of the acquisition? A. Yes, there were certain, of course, financing savings, more economical financing that could be achieved as a result of combining the two systems, as opposed to each going their separate ways. Then there were, which to my limited knowledge of operations I was convinced of, there were improved operations, more flexible operations, that could result from the combination of the two companies.

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Q. Mr. LaForce, under date of January 3, 1957, you addressed a letter to the Securities and Exchange Commission, in which you stated that a merger of Pacific into the company, being El Paso, on an acquisition of Pacific's assets by the company, would necessitate the refunding at the least of a substantial part of the outstanding debt securities of Pacific. Do you recall making that statement

in that letter? A. I think I do. Might I look at that letter, Mr. Kurtz?

Q. Oh, certainly. A. Yes, I'm familiar with that.

Q. And on January 8, 1957, El Paso issued its prospectus, in which it was stated, if the exchange offer is consummated, "It is expected that Pacific will be operated as a subsidiary of the company, and the management of the company has no present intention of merging Pacific into the company or having the company acquire Pacific assets. The reasons for this are that, (a) the agreement includes a representation to the effect; (b) the ruling of the Internal Revenue Service referred to above was made upon such representation; and (c), a merger or

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acquisition of assets would necessitate the refunding, at least, of a substantial part of Pacific's outstanding debt, which in the light of the present interest rates, could be done only at higher rates."

Now, my question is to you, at that time, what outstanding debt of Pacific did you have in mind that would have to be refunded?

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A. I had in mind the 4¼ per cent first mortgage bonds, the 4⅜ per cent mortgage bonds, and there was, of course, with respect to the term bank loans a prohibition against merger except with the consent of the banks. So I would say the outstanding first mortgage bonds and the term bank loans.

Q. Now, as I understand it, the proposal here, it does not include a refunding of these bonds, is that right? A. What is proposed, Mr. Kurtz—yes, there is not going to be any call or refunding. What we propose to do is issue to each of the holders of Pacific's outstanding bonds a like principal amount, with the same interest rate, same sink-

ing fund, same maturity as the Pacific bond, but this would be an El Paso bond, and it would be exchanged on a dollar for dollar basis. Therefore, it would not be a refunding that would entail higher interest costs.

Q. And I suppose that this plan that you have today was developed after you wrote this letter here? A. Oh, yes, and the circumstances are different, too, since that letter was written.

Q. Oh, how is that? A. I would say at the time the letter was written, it was still hoped there would be some earnings in '58, and that substantially higher earnings would be realized in 1959, whereas today, it has been testified that the net loss to Pacific

was $2,067,000, and a somewhat lower loss is expected in—I mean in '57 the net loss was $2,067,000, and a somewhat lower loss in 1958. I'm trying to think whether there was any testimony with respect to 1959 earnings, but I would say that nominal earnings, at best, for '59.

Q. You mean if you had to refund them today, that your costs would have been higher than you were even thinking about on January 3rd of '57? A. Yes. Let's put ourselves in the position of a lender, Mr. Kurtz, holding these bonds. Think what the situation is today in view of the actual facts. He has got a bond that is barely covering debt service. He's bought a bond that, as far as the interest charges—and by debt service I mean you take the earnings before depreciation and relate them to your interest and sinking fund requirements—it's barely being covered. As far as the interest charges on the Pacific bond, on an accounting basis after depreciation, they are not being covered one time. They may be covered on a cash basis.

Now, a lender is a little nervous about that situation. His portfolio is examined by insurance examiners. This is

what would be called, at the present state, a marginal investment, on the basis of the present facts.

Q. You mean the insurance company examiner would suggest that to the insurance company, that it might be marginal?

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A. Not only that, but more important than what the Examiner would say, the investment officers of the Life Insurance Company don't particularly like to have loans where there is no margin at all for their protection, and where a slight downward trend is going to make it difficult to service the debt of the company.

Q. I can appreciate that position of any lender.

Let's put it this way. At the time of January 3, 1957, what cost did you have in mind when you made this statement? A. Well, I had in mind this situation, that in three or four years down the road, when Pacific was in a strong and expected-earnings position that had been projected, and in view of the interest rates in those bonds, and on the basis of the present level of interest rates at the time of that January 3rd level, and if you went out and tried to merge, the insurance company holding the bond at that time, with that bargaining position of having strong earnings protection for his bond would say, no, if you want to get rid of this bond, interest rates are now higher; call it.

Q. All right. Now, let's go back to this. You had outstanding at that time, or Pacific had outstanding, 4¼ per cent bonds and 4⅜ per cent bonds.

Now, at that time, what interest rate would those same bonds have to be sold at? A. On January 3, 1957? Oh, it is difficult to pinpoint,

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but I would say on the basis of the market existing at that time, 5 to 5¼ per cent.

Q. And as of today, that interest rate would be higher? A. Yes, it would, Mr. Kurtz, unfortunately.

Q. At least from the position you are in now, is that it? A. Yes.

Presiding Examiner: Do I understand the creditor, here, to be willing to go along with this exchange of bond for bond, dollar for dollar, maturity date for maturity date, as you have indicated?

The Witness: I stated in my direct testimony, Mr. Examiner, that I had contacted several of the important holders of these issues, and that they were willing to go along on the basis of my discussions. I said it was my opinion that we could effect this exchange without any increase in interest rates.

Presiding Examiner: And they are taking El Paso's bonds as covering the whole integrated system, if the merger occurs?

The Witness: That is correct.

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By Mr. Kurtz:

Q. Well, as of today, what is the interest rate? A. For Pacific Northwest?

Q. If you had to sell, or El Paso had to sell, let us say. A. Well, I can only draw——

Q. Just a minute, Mr. LaForce. I apparently am mixed up myself. Let's start again.

If El Paso had to issue its bonds to refund the outstanding bonds of Pacific, at what rate would you say that El Paso could issue those bonds? A. Well, just thinking in terms of some of the recent sales that were made of pipeline bonds, and then relating it to El Paso, Mr. Kurtz, Texas Eastern sold a 5⅝ per cent first mortgage bond here recently at a discount, to yield 5.71 per cent; Tennessee Gas sold a 5½ per cent first mortgage issue. Since those

[redacted]

sales about a month or so ago, the market has strengthened somewhat. I would say that under present conditions today, for El Paso to sell a fairly sizable first mortgage issue——

Q. But at the size that you have outstanding? A. To refund those?

Q. Yes. A. Oh, I would say 5⅜ per cent, Mr. Kurtz; in that neighborhood.

[redacted]

Q. In other words, if the present holders of the Pacific bonds do not consent to the exchange plan that you have, then the cost to El Paso would be the difference between the combination of the 4¼ per cent bonds, the 4⅜ per cent bonds, and there is another issue outstanding? A. The 5 per cent issue; yes.

Q. And the issue of 5 per cent, as against the bonds of 5⅜; is that right? A. Yes, but I have testified that it is my opinion that we'll get the assent.

Q. I appreciate that. But in the event that you do not get the consent, that will be the cost to El Paso? A. Yes, if you assume that we'll raise the money to effect that call from the sale of mortgage bonds.

Q. I think you have added another expense item. There is a call premium on the bonds of Pacific; are there not? A. That's right, Mr. Kurtz; there is.

Q. Can these bonds of Pacific be called at this time? A. Yes. They can be called at this time, Mr. Kurtz.

Q. Do you know what the call premium provision, the cost to El Paso of calling the 4¼ per cent first mortgage bonds would be? A. I can very quickly get it for you. It's not a high call price, Mr. Kurtz.

Q. I'm just wondering if those call provisions are in

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this record. Do you know? A. I don't know. I don't think so, Mr. Kurtz.

Q. Well, could you get for us, at the recess time, the call provisions in the three issues of the bonds? A. I certainly could; I've got it in my bag, yes.

Q. Well, you can do it now, if you wish. A. There's a lot of different issues in this consolidated system. The 4¼'s, Mr. Kurtz, are callable at 104 to October 1, '59. The 4⅜'s are callable at 104⅜ to October 1, '59; and the 5's of '77 are callable at 105 until April 1st, '61.

Q. Well, if you are unsuccessful in getting the exchange of bonds, then the only alternative that you have is to call the bonds and issue new ones under the name of El Paso; isn't that right? A. No, I don't think that is quite correct, Mr. Kurtz.

Q. All right. What else could you do? A. We could do this:

We could assume those bonds as part of the merger plan. That means, then, a much more complicated operation. I shudder at the thought of it, but we could do this.

We, as part of this merger, we, of course, would assume all the debts of Pacific Northwest. We would assume the Pacific Northwest bonds, close the mortgage of the Pacific Northwest issue, and attempt to do all financing in the future under the

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El Paso mortgage that would have to be made a first and refunding mortgage issue, subject to the prior lien of the Pacific Northwest issue.

Q. That would almost become unworkable, wouldn't it? It could be done. A. Oh, I've seen more complicated arrangements than that, Mr. Kurtz.

Q. Well, between the two of them, would you recommend

the call? That is what I wonder. A. No, I wouldn't, Mr. Kurtz, because that would be a considerable increase in interest costs. I wouldn't want to do that, no. I'm on the other side of the fence now.

Q. I forget.

Then, as I understand it, if you do not get the consent for the exchange, you have the alternative at this time of El Paso—did you say "assuming"?—well, yes, El Paso assuming the obligations of Pacific under the bond, and the closing of those mortgages? A. The closing of the Pacific mortgage, yes. But I would reiterate that I believe very strongly that I think we can get this done on an exchange basis, without any necessity of resorting to that alternative.

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Q. And with what companies have you discussed this exchange? A. I have discussed it with the Metropolitan Life, which, as I have stated, owns about two-thirds of the Pacific Northwest bonds. I have talked to the Mutual Life Insurance Company of New York, that owned about 10 per cent of the Pacific Northwest bonds; the Guardian Life Insurance Company; and, on the basis of discussions, I reached the conclusion that I did.

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Q. Mr. La Force, as a director of El Paso, in the event

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that this Commission should happen to issue its decision in the instant docket, that is, Pacific Northwest Pipeline Corporation in Docket No. 13018, and El Paso Natural Gas Company in Docket G-13019, that it should not be granted, then at the next meeting of the Board of Directors of El Paso Natural Gas Company, would you initiate a resolution to divest Pacific Northwest Pipeline Corporation? A. You ask whether I would be willing to initiate it?

Q. Yes. A. In my own conviction, I would propose it.

Q. You would propose it? A. Yes.

Q. And why would you propose it? A. Mr. Kurtz, as you know, we have this antitrust suit that we have been struggling with since, as I remember, July of 1957. We have been hung, you might say, in Limbo here, neither fish nor fowl, trying to hold together the Pacific Northwest organization in the event that we have to divest, and appreciating the position of the people in that organization, trying to deal with it effectively in the way that we can improve it as quickly as possible, but not knowing what our position is going to be. I would say on the basis of the experience we have encountered to date, and the problems that would face us ahead, if this Commission would say in the public interest, with respect to these two highly integrated

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companies, that it is not in the public interest to merge, we've had it, Mr. Kurtz, and we might as well be realistic, face it, and divest it.

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By Mr. Kurtz:

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Consider Pacific as a separate corporation and also consider these market forecasts and including the sale of gas to the Provo line, the application that has been filed here; now, in relation to these earnings, what would be the amount of, the smallest amount of earnings that you would say Pacific would have to show to be able to finance on reasonable terms? A. Again I would like to give my answer, if that meets your question, in terms of a rate of return.

Q. Well, that is what I had reference to. A. Yes. I

would say with that Provo contract in existence and all the rest of it, and the decision of the Commission approving that particular line, that you could finance on fairly reasonable terms on the basis of seeing down the road that as your load expands, remember that the real impact of Pacific is not until 1962, as I remember those figures, that if initially, say in 1960, you could have a 5 per cent return, building up in that way you could get fairly reasonable returns, Mr. Kurtz.

Q. Would you have to have a 5 per cent return today to finance it? A. Today?

Q. Yes. A. Mr. Kurtz, today you have to meet certain earnings tests.

Q. Well—— A. As far as issuance of bonds in 1959, for example,

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you would have to be able to show coverage of interest charges after depreciation at 2¼ times. You would have to show coverage of interest charges before depreciation of 4 times. You would have to show coverage of total debt service, that is, interest and sinking fund requirements, of 1½ times.

Pacific just can't meet them. They are far, far removed from doing it. They just couldn't issue.

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Q. Now, I know that you have mentioned in here, but I don't—so that we may have them in the record, these earnings tests, would you mind giving them to us in as much detail as you have? A. Yes. In order for Pacific Northwest to issue additional first mortgage bonds, it is required that the following earnings tests be met, and when we talk about requirements, that is, interest and sinking fund, we

are talking about the outstanding issues plus the new issue to be sold in computing those requirements.

Now, as far as earnings before depreciation, they have to cover interest requirements four times and they have to cover total debt service requirements, interest and sinking fund, 1½ times, and then on the basis of earnings after depreciation, you would have to cover those interest requirements 2¼ times.

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Do you know of any reason, you yourself, why Pacific should not receive its full cost of service for delivering gas to other pipeline companies, and I have particular reference to the other pipeline companies being Mountain Fuel Gas, Colorado Interstate, and El Paso. A. Yes, I do.

Q. All right. Why? A. The question of load building and the question of public relations in the building of acceptance of gas.

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Q. We are talking in general terms now, and I want to get your—it is a policy matter, as a director of Pacific. A. Well, let me go right to the—in answer to that question, to the rate increase that Pacific put into effect,

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that five-million-plus rate increase. You mentioned Mountain Fuel Supply. Now, the rates at that time to Mountain Fuel Supply and C.I.G. were raised proportionately more, it is my understanding, than the rates to the distribution companies on Pacific Northwest's system. There was a great cry and outbreaking of protest from Mountain Fuel Supply and the Governor and the State, and so forth, that here was a philosophy that you initiate service and

then you immediately raise the rate, and, if that is the attitude, how can you expect anyone to start to buy gas if, immediately when it becomes competitively possible, you raise the rate?

That is what I meant when I referred to the conditioning requirements of needing to build load and the problem of public relations.

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By Mr. Bennett:

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Q. Now, how about 1959? What did you expect with reference to earnings on the B stock? A. We expected that in earnings in 1959 the net for the common of Pacific Northwest would be approximately $6.5 million.

Now, I would also like to qualify that, Mr. Bennett, to this extent, that there is always the question of the tax benefits resulting to El Paso as a result of this acquisition,

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and the fact that we would, commencing as of January 1, 1957, be entitled to include Pacific Northwest Pipeline's operation in the filing of a consolidated tax return.

To illustrate what I mean, in the year 1957 the net loss of Pacific Northwest, as I have stated, was $2,067,000. The tax benefit to El Paso as a result of including the operations of Pacific Northwest in its consolidated tax return were roughly $5,300,000. So that in effect, giving recognition to that tax advantage, Pacific itself did in the year 1957 make the contribution to the consolidated net earnings of El Paso in the amount of $3,300,000, approximately, and that same condition will apply in the future.

Q. Then that is—that tax saving is a recurring condition,

is it? A. Well, it will be, Mr. Bennett, in my opinion for two, three, four years. In addition to that, of course, if we are able to merge, we get the benefit of that tax loss which was incurred up to January 1, 1957. These tax considerations were of considerable cushioning impact with respect to the earnings that we were going to get out of the Pacific Northwest picture.

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Q. Well, is there any reason why this situation couldn't be cured by a filing on the part of Pacific for a satisfactory rate increase? A. Yes. The problem that I discussed at some length with Mr. Kurtz, and that is the problem of building customer load without incurring customer wrath, particularly where you are trying to build it in an area, Mr. Bennett, that has never had gas to any great degree. A new company has been formed where they have had low-cost electricity, and where your competitive differentials—they are not in the fortunate position there as in California, where gas is much cheaper than competing fuels. Your competitive differentials are much smaller. You have got a problem there of building customer acceptance, and you just don't go out and file a rate increase.

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Q. In other words, then, if Pacific were to survive as an independent company until the year 1962, it would then be in satisfactory financial condition. Is that your opinion? A. Not "satisfactory financial condition", Mr. Bennett. I would hope that in that intervening period we might have favorable development occur that you can't foresee. A new industry might locate there. We are working all the time to try to improve the earnings picture. That is the best as we see it right now.

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Q. Well now, even though it stays an independent company, this area which you talked about and which you have such confidence in, the growth is going to continue there, is it not? A. I expect the growth will continue in the Pacific Northwest; yes, certainly.

Q. There is going to be a population increase there regardless of the merger or not. A. I believe so.

Q. So it is your opinion that if these things come to pass by 1962, then Pacific's position will be financially improved and satisfactory? A. I am saying that on the basis of the assumption that this Provo line is built and that Pacific Northwest's facilities are utilized so that you have a much higher load factor operation, that you will then in the year 1962 be on the way to achieving satisfactory earnings. Those earnings by themselves are not satisfactory, to my way of thinking, but they are an indication that Pacific is being built up to the point where a continued improvement can be expected, and that is what investors look to. They look to the future in the hope that earnings can be brought up.

Q. So that regardless of the point in time when this state of satisfaction is arrived at, it is inevitable, I take it, with Pacific as an independent company; is that correct?

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A. Nothing is inevitable in life, particularly business life, Mr. Bennett.

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Q. As a Director and Vice President of El Paso, Mr. LaForce, is that corporation planning to file with this Commission an application for a rate increase in the near future? A. El Paso?

Q. Yes, sir. A. We are constantly reviewing, Mr. Bennett, a problem of adequate return on our investment. In my opinion, Mr. Bennett, such a rate increase application should be filed, yes.

Q. And do you have some idea of the time when that application might be filed? A. No, I do not.

Q. Well, when in your—— A. As soon as possible, I would say, speaking as a financial man.

Q. As a financial man is it your opinion that such an application has to be made, that it is necessary to the financial well-being of the company? A. El Paso?

Q. Yes, sir. A. Yes.

Q. And so far as you are concerned, you say it should be done as soon as possible? A. Yes.

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Q. Well, why are you so—why is it that you are anxious, if that is the correct word, to file a rate increase for El Paso as soon as possible, but you have this apparent reluctance to file one on behalf of Pacific Northwest's system? A. Mr. Bennett, when El Paso was first built, exactly the same problems were encountered in the building of customer acceptance of gas by El Paso as are now being encountered by Pacific. I would say it is a problem of selling gas, and you don't in a new area such as Pacific, where they have never had gas, immediately prevent yourself from achieving earnings and the building of gas load before you have any stability that a customer can look for with respect to the building of a load. You don't go out and put one rate increase on top of the other.

Q. Are you saying, then, that as you understand the consumer sensibilities of Californians, that there is little resistance to rate filings so far as they are concerned, but the people in the Pacific Northwest are a little bit more reluctant to take on added burdens with reference to their gas uses? A. Mr. Bennett, I am trying to be realistic and

practical. Let me state again that I have been very much impressed with the terrific expansion of El Paso to serve its markets and the most important market of El Paso is California, with

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the result that the price to consumers in California today, as far as the residential cost of heating for Los Angeles and San Francisco, it is the lowest in the first five lowest cities of this country.

The cost of residential fuel heating in the City of San Francisco is lower than it is in Houston, Texas.

Q. You are not in the Public Relations Department, are you? A. No. I think it is time we talked about facts, Mr. Bennett.

Q. But according to your testimony, you want to file a rate increase for El Paso, the principal customers of whom are Californians, and you want to do that as soon as possible. Is that correct? A. Yes, because I can see higher costs that we are going to have to pay here for gas, and that I do not think El Paso should subject itself to lags whereby it is not earning a fair return. It pays costs and does not recoup them, Mr. Bennett.

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Q. Well, you just told us that you think El Paso should have no time lags and it should earn a fair rate of return. Isn't that your testimony? A. Of course, but it is a matter of business judgment as to how you go about earning a fair return. In a new company that is trying to get on its feet, you don't say the way to get the return is to put in a rate increase.

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By Mr. Bennett:

Q. Mr. LaForce, when you talk about a rate increase for El Paso, how much of a rate increase do you have in mind? A. I have not directed any study to that extent, Mr. Bennett.

Q. Is one of the purposes of that rate increase to permit the El Paso corporation to earn sufficient to meet the obligation represented by the additional shares issued to acquire the Pacific stock?

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A. Most certainly not.

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L. Emery Katzenbach

resumed the stand, and, having been previously duly sworn, was examined and testified as follows:

Presiding Examiner: Are you ready to begin the cross-examination, Mr. Kurtz?

Mr. Kurtz: Yes.

Cross-Examination

By Mr. Kurtz:

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Q. Well, now, let us take Pacific's system. It has had a loss. It is coming into an improved financial position. Management thinks that it is. And they have made forecasts of it. They are going to supply gas to a new proposal that has been filed here known as the Provo-Las Vegas line that would inspire confidence in the investor, wouldn't it? A. Not a great deal.

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Q. It wouldn't? A. No, sir.

Q. Why not? A. Well, first of all, Pacific Northwest, as we know, has had disappointing results in the rate of attachment of customers in its territory. It has sinking fund obligations on the securities that it has previously sold. Those sinking fund obligations commence in 1958. They step up in 1959 and, as I recall, they hit their full stride in 1960.

The Provo-Las Vegas line is a proposal at this stage of the game. It has not been approved. It would not at the present time form the basis for future financing.

But let us assume that it had been approved. The deliveries under that project, as I recall, don't commence

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until 1960 and then only in part. They do not reach their full volume until 1962. In the meantime Pacific has got some serious financial hurdles to get over, and even if we assume, in my opinion, that the Provo-Las Vegas line is an approved project, I think that someone being asked to buy securities in Pacific Northwest at this time would not be looking at it with a feeling of great confidence about its ability to weather the period immediately ahead over the next couple of years. It doesn't present a strong picture to an investor.

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Q. And the reason it does not present a strong picture is the earnings of the company, is that it? A. Well, the earnings are at the root of the whole affair. That is, I think, a correct statement.

Q. As I understand from what you have said, you have given some thought to it but you do not know at this time, or would not care to express an opinion, as to the level of the earnings of Pacific for it to finance. Is that right? A. If by that, Mr. Kurtz, you mean the level of earnings that

one can point to in the last preceding year, my answer is that that is not enough in and of itself to give you the answer to your question, "Can you finance on satisfactory terms?"

Q. Well, let us put it this way, turn it around.

Now, taking the Pacific Company, what in your opinion would be necessary for it to finance on reasonable terms?

A. In order for Pacific Northwest to finance on reasonable terms, I would say that the company would have to be in a position in relation to its current earnings, in relation to its prospects, that the investor would be able to satisfy himself that their present commitments, that their additional commitments for the new securities, can be comfortably met with some margin of safety for error, and that the outlook is one which, over a period of time, even if it isn't yet earning a satisfactory full rate of return, the outlook will be such that you can look with confidence toward that being achieved

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within a reasonably short period of time.

Q. And when you use the term "reasonably short period of time", could you make that a little bit more definite, because we might be thinking of different things. Would that be in terms of—in terms of years, what are you thinking of?

A. Well, two, three.

Q. I think we are all in agreement, are we not, that eventually every company has to earn a reasonable rate of return or it cannot finance. That is what you have to look for down the road.

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Presiding Examiner: At this break in your cross-examination, Mr. Kurtz, let me clarify my own mind, and for the record as it stands I ask you, Mr. Katzenbach, whether in

your discussion, the earlier part of your discussion with Mr. Kurtz on the subject of financing—I had in mind the financing of extensions and such that money, ready money, would be needed for, and you kept speaking in that regard of the investor. Now, you were speaking of the bond investor at that time, were you not?

The Witness: Well, in some questions perhaps so, but I think that it applies to all classes of investor, Mr. Examiner.

In other words, the conditions which are such that will enable the company to sell its bonds on satisfactory terms are

pretty generally the same conditions which enable that same company to attract other forms of security issues.

Presiding Examiner: I was thinking particularly of the questions that have been answered here of Pacific being able to finance certain projects, further projects than their initially certificated project. That is what I was thinking of. That to my mind took bonds. Of course, we know stock could be issued, if you have enough of it.

The Witness: Yes, sir. It takes bonds, Mr. Examiner, and it also takes equity because you can not finance additions or extensions to a system solely on bonds if you are already up to the limit in your overall capitalization of the amount of bonds or debt that you should have outstanding.

Presiding Examiner: Well, I merely wanted to clarify this. There has been discussion of both things and I wanted to see where you drew the line.

By Mr. Kurtz:

Q. Mr. Katzenbach, a natural gas company that has subsidiary corporations—in your opinion does that affect that company's cost of money? A. I think in many circum-

stances, in fact, in any such circumstance the answer is Yes. In some cases a great deal more than others.

In the case of Pacific versus El Paso, I think it has a very pronounced effect to the detriment as compared with one

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overall operation. I think it results in complexities which are confusing to people who are being asked to buy securities. And those complexities you might say are something that management can deal with. It may cause them a lot of extra trouble. But when you come down to the nub of the thing, the fellow who is buying the securities has got to understand it, and in many cases he has got to present it to a committee.

Now, if you have a complicated situation as between two companies, such as you have and will increasingly have, would increasingly have in this case here, it takes a tremendous amount of study and understanding for the investment officer to become acquainted with the situation. He is not going to go to all that trouble if the rate of interest on what he is buying is not sufficiently attractive as compared with other simpler opportunities that he has. He isn't going to bother to put it up to his investment committee who are going to have questions and prejudices and misunderstandings.

So I think that the complexity factor is one which is important to consider. I think it raises questions in the minds of investors—this is related to the complexity question—on where they are engaged in the same businesses and they are closely operated and integrated, the questions of business opportunity. If you are the holder of Pacific Northwest bonds and the company has a proposal to add some

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extensions or additions to the system, he is going to say, well, why don't you let El Paso finance that? Isn't there a way they can do it so that we don't have to buy more bonds? So then you come around to trying to do something for El Paso and you get the other side of the coin.

You have, as I see it, all sorts of problems which are real problems from the standpoint of investors. That is, bond buyers, preferred stock buyers, and the common stock buyers which, of course, would only be in the parent company.

Now, there are other cases, there are many cases where companies do business through the form of parent and subsidiaries, and those are usually cases where there is some compelling reason why to use a subsidiary even though the cost may be a little bit more or considerably more, or it may be a different line of business which lends itself to a different financing pattern.

Pipelines are financed one way. In distribution companies the pattern is different. And if you tried to combine the two of them in a case of that sort, you would probably wind up with the worst of both of them, whereas if you do them separately, you can get the advantages of a separate operation.

So, the question of whether or not a company can satisfactorily finance when its operations are in part carried on by a parent company and in part carried on by a

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subsidiary company, I don't think lends itself to a general answer.

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Q. There may be projections of companies in other various forms, but they all have some type of subsidiary

companies that are going corporations, do they not? A. In the technical sense, that is true. As a general proposition they do not separate like functions of the business into subsidiary operations because of the disadvantages that go with it.

Q. You say "like functions".

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A. By that I mean, Mr. Kurtz, if you are engaging in the production business, you usually do your production business through one subsidiary, except where it is absolutely impractical to do so, instead of separate subsidiaries individually engaged in the production business.

If you are engaged in the pipeline business, except for special reasons it is more advantageous, obviously, to carry on all of your pipeline operations through one pipeline company.

If you are in the distribution end of the business, to the extent that you are in the same state or in the same city you carry on your distribution operations through one company. Frequently when you cross over into another state, state laws require you to have a separate subsidiary.

Q. All right. Then, if I understand you correctly, if you have a company, a transmission company, that has its production under one or more subsidiaries and also is engaged in distribution, and it has its distribution companies in one or more corporations, that fact alone would not affect that company's cost of money? A. If separate activities are each conducted by one corporate enterprise or subsidiary, then I don't think that you necessarily suffer any disadvantage from a financing standpoint.

Q. In other words——

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A. Where you do suffer a disadvantage, in my opinion, is where you separate into separate subsidiaries, or try to conduct as separate subsidiaries businesses that are of

the same type and which are closely related and integrated with one another.

Q. Under separate management. Do you want to add that to your—— A. Well——

Q. If you have one management, it doesn't matter about subsidiary companies. It is where you try to conduct these subsidiaries under separate management. That is where you have your problems. Is that it? A. No, it isn't the management situation that brings about the problem. If you have a subsidiary, I am assuming that the management of the parent company is responsible for the management and the operations of the subsidiary.

You might have a situation where your Boards are not absolutely identical, but generally speaking, they are under one general overall management policy. And where that is the case, the operation of a given form of business of two or more, one or more subsidiaries, and a parent company, is more costly and more complicated and has many disadvantages over the operation of that particular line of business in one corporate entity.

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One of the serious things about this whole question, it seems to me, is this, and this is something that investors are looking at. El Paso, if it merges with Pacific Northwest, would be able to take and make use of a provision in the tax law with respect to the carry-forward of losses incurred by Pacific prior to the time of its acquisition. That carry-forward loss, as has been brought out here, amounts to something like $23 million. Pacific Northwest unmerged, on

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its own, or even as a subsidiary of El Paso, from all I can tell is never going to get the benefit of that carry-forward

loss, and that is a feature which makes it possible for El Paso, as a merged company, to carry this thing along which Pacific on its own is in an ever so much more difficult position to do and needs more time to accomplish, and I think that has a bearing also on the ability of Pacific Northwest to hold its rates because if this carry-forward goes down the drain, as it were——

Q. In so far as El Paso is concerned. A. So far as Pacific is concerned.

Q. When does it go down the drain? A. Well, as I understand the situation, Mr. Kurtz, Pacific Northwest--and this is customary with any construction project—started off operations with——

Q. We know the dollar amount. A.—with the carry-forward loss.

Q. Just a minute. We know the dollar amount, but when would it go down the drain so far as Pacific is concerned in time? A. Well, I believe that it can be carried forward for no more than five years. Each loss can go forward five years. Now, the loss, as I understand it—and perhaps this might be more properly brought out by some other witness —but as I understand it, the end of the period is the end of 1956

that we are talking about. Now, Pacific on its own, even if it were reporting earnings in its report to stockholders and in its report to the Federal Power Commission under the Uniform System of Accounts, even if they are reporting earnings there, they would be showing tax losses arising by virtue of the deductions from the declining balance method of depreciation as distinguished from the straight-line method, and therefore from all I can gather Pacific is not going to have, even under an improving earnings picture, enough taxable income on its tax books to be able

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to use or absorb the $23 million of tax losses which go back prior to January 1, 1957.

The only way that I understand that that provision which is in the tax law—the only way that those advantages can be obtained is through a merger and it doesn't come about, in other words, with Pacific operating as a separate company, either as a subsidiary or as an independent company.

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Cross-Examination

By Mr. Bennett:

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Q. What are you relying upon this time, as to the benefits in the future?

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Now, here we are not relying on engineering surveys or geological reports in reaching the conclusions that we reached with respect to the benefits of the merger. We are talking about such things as the greater simplicity that arises from a financial standpoint. That is a matter which is directly within our field of day-to-day experience. It is the kind of a problem we are facing day by day. We recognize and see the problems that there are in connection with trying to finance these two operations in the absence of a merger, where you have got two different mortgages which we are thoroughly familiar with.

In fact, we have taken a very active part in the negotiation of the terms of those mortgages. We have first-hand knowledge of what they are. We are aware of the fact, for example, that El Paso cannot build any proper-

ties on the right of way of Pacific, or Pacific can't build any properties on the right of way of El Paso, and that you can't, in El Paso's case, subject any of its property to a prior lien of Pacific Northwest, and the same thing the other way around.

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We are aware of the fact that the El Paso mortgage has got one set of terms and provisions with respect to the acceleration of sinking funds, with respect to gas supply, and that there is a totally different set of terms and provisions with respect to Pacific Northwest. We take that and a whole bunch of other considerations, most of which I have referred to here, and some of which I haven't. I haven't been questioned about them. They are things which are in our first-hand knowledge, and are things that we are dealing with from day to day. I wouldn't put them in the same kind of category as a question of looking at an estimate which was made by a firm of economists or analysts or geologists, and then relying on their estimates.

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Q. Do you expect them to make earnings sometime in the future? A. Yes.

Q. Did that expectation come into your forecast consideration? Did you take that into account when you were talking about benefits? A. Yes, we expect Pacific to earn money in the future.

Q. When in the future? A. I think they might earn a small amount of money in 1959.

Presiding Examiner: You are speaking of net earnings, of course; are you not?

The Witness: I am speaking of net earnings before common dividends. I wouldn't be surprised from all I can

gather, that Pacific would be unable to earn its preferred dividend requirements out of operating earnings in 1959.

By Mr. Bennett:

Q. When, in your opinion, will Pacific reach a state of satisfactory earnings? A. I'm not counting on Pacific Northwest reaching a state of satisfactory earnings for at least four or five years.

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Q. Now, if your expectation of no satisfactory earnings with reference to Pacific is correct, for at least four or five years, who do you expect to carry the deficiency which will be within the merged system, then, because of the Pacific situation? A. Well, I think the security holders of Pacific Northwest will have to worry along during this period, here. El Paso is in a position, if the companies are merged, to take advantage, as I said before, of this carry-forward provision which the law provides. It makes the sum of the—it makes

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the whole picture, in other words, greater than the sum of the two separate ones, in that respect. I think that is an important factor.

I think that Pacific Northwest will begin to generate some earnings. I think that from the standpoint of El Paso's stockholders, they will—and they recognize this—undergo, let's say, a period when, a period of time until Pacific Northwest is able to carry its full share or contribute, I should say, its proper share of the earnings of the two. But I think the long-run economics of the situation are constructive from the standpoint of El Paso's stockholders, as well as consumers.

Q. Wouldn't that have an effect upon this 14 or 15 per

cent return you recommend on the common stock? A. I don't understand your question. Pacific Northwest, I said I didn't think would achieve a satisfactory level of earnings for four or five years.

Q. I mean with reference to El Paso's stock. A. Well, I'm talking about earnings on the book value component of the capitalization of the El Paso System, or in any other pipeline, when I'm talking about what they should have as a fair rate of return.

Q. Well, won't this situation you talk about affect that in some degree, at least? A. On a consolidated basis, as I have just said, I think

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the stockholders of El Paso recognize that they will have a period there where, if Pacific Northwest is unable to contribute its proportionate share of the earnings, I don't expect that the existing El Paso System is going to up its earnings to a point which is to carry along the Pacific Northwest; so, therefore, I think that the burden of this, during the time it takes to materialize, is going to be felt by the El Paso stockholders. I don't expect the El Paso System, as it presently stands, to underwrite, in effect, and overcome and offset the deficiencies in full rate of return for Pacific Northwest.

Q. Well, then, is it your opinion that the existing El Paso customers should not make up or pay for the deficiencies which are going to exist in the merged system because of the Pacific Northwest financial condition? A. I don't expect that the existing customers of El Paso should start paying higher rates right now just to overcome the fact that Pacific Northwest, right now, isn't able to earn what I consider to be a satisfactory rate of return on its investment, to the effect that the company can not be able to earn the full rate of return on the consolidated capitalization.

Q. Now, when you say, "I don't expect," do you mean by that that you think that that should not happen? Is that what you are saying, rather than some expectation? A. No, I don't think that should happen, and I don't

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think, from all I can gather, that it is the company's intention, either, that that should be the case.

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Q. Well now, do you consider that the stock acquisition plan of El Paso, as it has been executed, whereby the earnings, according to the testimony—that is, the earnings of El Paso—were diluted, helped to improve that situation we are coming to, so far as El Paso's financing possibilities are concerned? A. I look at it this way, Mr. Bennett, and I have talked with many, many investors and holders of El Paso on this very subject.

When El Paso made the offer for the stock of Pacific Northwest, many stockholders of El Paso addressed themselves to the question, is this going to bring about a dilution of El Paso's earnings per share?

I think that almost universally, stockholders generally felt that it was a sound move, it created a system which put itself in a much better position to serve its continuously growing markets. And I think that obviously the purchasers of securities of a pipeline or a utility or of an industrial, they want to see that company grow with growing markets.

They felt that this created an excellent system to continue to grow and to serve its markets.

Q. Pardon me one moment. When you say "they", have you talked to some of the stockholders about this? A. Oh, I talk to them every day.

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Q. How many stockholders of El Paso do you mean when you say "they"? A. I'm talking to institutions, to banks, to investment companies, to trusts, all the time. We are in the investment banker and broker business, Mr. Bennett, and it is our job to be in touch with customers. That is our business.

Q. Mr. Katzenbach, this stock acquisition program, however, did dilute the earnings of El Paso, did it not? A. The effect on the earnings of El Paso have been such that had El Paso not issued the additional 5,200,000 shares, the earnings of El Paso would have been somewhat better than they are.

I was about to say before, and I think I hadn't finished my answer to the first question before you interrupted me——

Q. Is the answer to the question, then, yes, as to the dilution of earnings? A. Thus far it has.

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The Witness: Well, immediately, they did foresee dilution. They recognized this tax situation. They recognized that El Paso would be able, because of the consolidation of tax returns, to feel this dilution less than would at first appear, without taking the tax consideration into mind.

They felt, as I was about to say, that it was a constructive, long-term development for El Paso, and they were therefore quite happy to undergo the immediate dilution for what they considered the long-term, constructive aspects of the stock acquisition.

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Q. Well, now, in your opinion, Mr. Katzenbach, should the Pacific, or should an application be filed, with this Com-

mission on behalf of the Pacific Northwest Company, seeking a rate increase so as to improve earnings? I'm talking now about investor appeal, again, which is your field. A. Well, as I analyze the situation, Mr. Bennett, Pacific

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Northwest's objective is to get its market developed and its earnings up as soon as possible. I think that to file a further increase on Pacific at this stage of the game would be approaching the point of diminishing returns in delaying the achievement of the volume of gas sales which Pacific is trying to develop.

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Further Cross Examination

By Mr. Kurtz:

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Q. As your opinion. But as a financial man, you would like to see El Paso earn, overall, after the merger, this reasonable rate of return, would you not? A. That would be very nice.

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Q. And you have mentioned Mr. Kayser's testimony. Were you here when Mr. LaForce testified? A. Yes.

Q. In making up and giving that answer, did you give consideration to the benefits that the El Paso company would receive from acquiring Pacific as here outlined, particularly the attachment of new sources of supply? A. Yes, I have always regarded the attachment of new sources of supply as being an important aspect of this stock acquisition and merger.

Q. And do you not think that the customers of El Paso's present system, if they are to benefit that way, should pay for part of those benefits? A. Yes, I do.

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By Mr. Kurtz:

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Q. Now, this lot of earnings, or non-satisfactory earnings of Pacific that you are making as more or less a general statement, as I understand it, and you do not have at this time any idea of the dollar amount of those earnings; is that right? A. I have an idea of the dollar amount of those earnings for 1957.

Q. What is the dollar amount of earnings, then, that you have in mind? A. In 1957, Pacific Northwest showed an operating loss of $2 million 60-some-odd-thousand before giving effect to profit on sale of securities in the amount of $1,700,000.

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Q. All right. 1958? A. In 1958, we have no definite earnings as yet, of course, Mr. Kurtz.

Q. Well, these lack—these dollar amounts that go to make this lack of satisfactory earnings, that is what we are talking about now. Do you know any dollar amount? A. I was trying to say, Mr. Kurtz, that I understand that Pacific Northwest had shown a loss of approximately $1,900,000 through August 31, and that the expectation, as expressed by Mr. Silloway, was that the company would show a loss for the year as a whole of around $1.5 million.

Q. All right. Now, my question to you, sir, was, what is the dollar amount of the satisfactory earnings required for Pacific? Do you have any dollar amount in mind? A. Not without taking their rate base and running a pencil calculation on the type of rate of return that I consider appropriate, and carrying it down through and bringing it out to a dollar figure.

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Q. All right, then, what you are saying is that at this time you do not have a dollar amount in mind. A. I have a rate of return figure in mind, rather than a dollar amount.

Q. All right, what rate of return figure do you have in mind? A. I consider that a satisfactory rate of return on Pacific Northwest would be such, on an overall basis, as to produce a rate of return of 15 per cent, more or less, on the common stock equity component of its capitalization.

Q. And you think that Pacific will not reach that, except for four or five years? A. As it looks now, I don't think that will be the case, Mr. Kurtz.

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2248

Harold C. Frank

resumed the stand and, previously duly sworn, was examined and testified as follows:

Cross-Examination

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By Mr. Letton:

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Q. Now, you referred to a price or cost, rather, of 26.04 cents as being the most recent estimate applicable to the proposed new gas supply of P G & E at the U.S.-Canadian border. Is that right? A. Yes, sir.

Q. What average field price of Canadian gas is that based upon? A. That was based upon a 14.69 cents per Mcf.

Q. And what is the estimated cost of that gas at the Alberta border? A. Mr. Letton, I am not too familiar with the study.

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I have certain figures here which I don't know that I might be interpreting properly. I was instructed to bring back certain cost figures, and I have done that.

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Q. How about the price delivered to Antioch? What does that amount to?

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A. The cost of gas delivered at Antioch is 45.51 cents per Mcf.

Q. 45.51 cents, Antioch is the Southern terminal of the proposed new transmission line; isn't it? A. That is right.

Q. Near the San Francisco Bay area or in it? A. Yes, sir.

Q. Now, what volume of gas was used to prepare these most recent studies? A. A volume of 400 million cubic feet a day.

Q. And you stated, I believe— — A. Excuse me. I should say that is at Antioch.

Q. I beg your pardon? A. Excuse me. That is at the California-Oregon border of 400 million cubic feet a day.

Q. In other words, you used that volume as far down as the California-Oregon border. Is that what I understand you are saying? A. I believe there was a greater volume than that put into the line at its initial point. At the California-Oregon border there was an amount of 400 million cubic feet a day.

Q. Well, can you tell us what the volume was when it started out at the Canadian border? A. The volume of 164,542 M³cf.

Q. Well, that is the annual figure you are giving us;

is that right? A. That is right.

Q. What would that be on a daily basis? A. 450 million cubic feet a day.

Q. 450? A. That is right.

Q. Could you tell us what accounts for the difference between the 450 million at the Canadian border and the 400 at the California-Oregon border? Are there some sales made in between there somewhere? A. I believe there are some taps off the line.

Q. What is the purpose of those taps; to serve what customers?

Mr. Furbush: Mr. Examiner, I wish to object to this line of testimony as having no relevancy to these proceedings here at all. It is merely a fishing expedition by our sister companies in California for information for their own purposes and it has no relevancy whatsoever to this proceeding.

Presiding Examiner: What have you got to say, Mr. Letton?

Mr. Letton: Well, Mr. Examiner, it is not a fishing expedition at all. This witness has been presented at the request of Mr. Kurtz at this hearing to offer certain cost figures applicable to the P G & E project.

Presiding Examiner: You mean the P G & E Canadian project bringing in Canadian gas?

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Now, can you re-ask your question, because you do have the right to ask him how he arrived at his figures. That seems to be very plain. But what was the particular question now?

Mr. Letton: The particular question, Your Honor, was with relation to a part of the way in which these cost fig-

ures were developed, and I asked what accounted for the difference between the use of 450 million as the volume to be transmitted at the Canadian border and 400 million at the California border. I think that is relevant to the determination of the cost at these various points.

Mr. Grambling: He answered that.

Presiding Examiner: I think he answered that by stating there were some taps along the line. That is all he knew about it.

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Q. Mr. Francke, do you have figures under this more recent study that you referred to applicable to one of the later years of operation, say, the third year of operation? A. Yes, I have certain figures.

Q. All right, sir. What—— A. On the fifth year of operation, Mr. Letton.

Q. Which year? A. Just the fifth year of operation.

Q. Just the fifth year. All right. What is the average field price applicable during the fifth year of operation? A. The field price is 17.12 cents per Mcf.

Q. And do you have the Alberta border price after the fifth year of that operation, Alberta border cost, rather? A. I have the fifth year cost at the California-Oregon border, Mr. Letton.

Q. All right. What is that? A. That is 43.54 cents per Mcf.

Q. And what is the cost of the fifth year delivered at Antioch? A. 47.99 cents per Mcf.

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By Mr. Furbush:

Q. Mr. Francke, what would the price at Antioch be in the fifth year of operation if the project were increased

to 600 million instead of 400 million per day by that time? A. I was informed that there would be a reduction and it would amount to approximately 5 cents an Mcf.

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By Mr. Letton:

Q. Do you know, Mr. Francke, whether there will

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actually be 400 million cubic feet a day delivered through the pipeline during the first year of operation, or will it be less?

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The Witness: Well, as far as I am concerned, sir, in the first year of operation it would carry 400 million a day down to Antioch.

Mr. Furbush: So that we can relieve Mr. Letton's concern, I will advise him that Pacific Gas and Electric Company's subsidiary in Canada will revise or have revised their application before the Board showing additional reserves. The reserves which were used before that Board, and on which its previous decision was based, were reserves as of March 31, 1958. Since then additional reserves have been obtained under contract by Pacific Gas and Electric Company's subsidiary, and it is anticipated that there will be a decision by the Board up there justifying the 400 million Mcf per day project.

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2276

Keith Kelsey

was recalled as a witness and, having previously been duly sworn, was examined and testified as follows:

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By Mr. Bennett:

Q. What percentage or portion of the gas demands of the Pacific Lighting group is furnished by El Paso? A. Oh, I believe it is of the order of magnitude of 60 or 70 per cent.

Mr. Bennett: All right, thank you. That is all I have.

Presiding Examiner: Are the other sources local in California?

The Witness: Yes, sir.

Presiding Examiner: In other words, the only supply of gas coming to you from outside the State is furnished to you by El Paso?

The Witness: At the present time. We have a letter of intent from Trans-Western Pipeline Company, but the deliveries haven't started.

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Further Cross-Examination

By Mr. Kurtz:

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A. The Pacific Lighting Gas Supply Company entered into a letter ~~agreement~~ dated February 7, 1958, with Trans-Western Pipeline Company, together with amendments dated July 2 and July 18 for 350 million cubic feet per day of out-of-state gas supply.

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2298

W. V. Holik

was recalled as a witness and, having previously been duly sworn, was examined and testified further as follows:

Mr. Grambling: Do you want to proceed, Mr. Kurtz?

Mr. Kurtz: All right.

Cross-Examination

By Mr. Kurtz:

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Mr. Holik, you referred to the fact that Pacific had realized a capital savings of approximately $4.5 million as a result of exchange agreements in the San Juan Basin. A. Yes, sir.

Q. As I understood your testimony, both El Paso and Pacific agreed to an orderly development of the San Juan Basin before Pacific even started to take gas from that basin; is that right? A. That is correct, sir.

Q. And this $4.5 millions' saving—am I correct in my understanding of that: that that relates to the cost of con-

2323

struction of their initial gathering system? A. No, I wouldn't say that, Mr. Kurtz.

Q. Well, what I really wanted to clear up was this statement that you made on page 413. I'm just wondering if that refreshes your recollection on it. A. What I was referring to here in their initial gathering system was the fact that El Paso was furnishing or had agreed to furnish them volumes of gas. I believe it was 100 million per day for the first three years, then 60-40, which enabled them to have a volume of gas to meet their needs initially without having to go out and put in gathering facilities right then and there.

Now, I do not mean to confuse that with the $4.5 million.

Q. I see.

Well, how did you make up this estimate of $4.5 million? Do you have any breakdown of that figure? A. What I did, Mr. Kurtz, was to have estimates prepared on the basis of the non-unit wells at San Juan.

Q. On the basis of what? A. Non-unit wells. That is, wells that are outside of a participating unit agreement. To have those wells only, the number of wells that Pacific Northwest had tied into our system, and an estimate made of the cost to Pacific of having that many wells with their own laterals, trunks, and so forth, and tying them into Pacific's system, versus the cost of tying

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them into El Paso's system on the basis of the wells that we had estimated at the time.

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Q. What you mean by that is that you would have $4½ million as a saving in duplicate facilities? A. If they had tied-in all the wells that they had—

Q. Anywhere in the field? A. Outside of participating unit areas.

Q. What do you mean by "participating unit areas?" A. Areas that are set up under a unit agreement, say, between the owners—usually a block-type unit in, say, a township and range block, where a pipeline can come generally to a central point to get delivery. I excluded those in an attempt to have no disagreement there, and went to only wells that were outside of that unit, where PNW had an interest.

Q. Well, in these unit blocks, Pacific has an interest in some of them, doesn't it? A. Oh, yes.

Q. In making up your gathering system design, did that gas go to El Paso, or did it go to Pacific? A. Well, in that

case, I would tie it into Pacific's system to get a cost, and then tie it into El Paso's system to get a cost, and the $4½ million is made up of the difference on all of the different wells throughout the Basin.

Q. Well, I'm talking about these areas where you have this unit agreement. A. Oh, you mean in the participating unit agreements?

Q. Yes. Now, under your outline of the gathering system,

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who picked up that gas? Which company? A. I think both companies are in various of those units, Mr. Kurtz. Some of them are operated by PNW, and they have most of the trunks in them, others by El Paso. Others, I think, there are even cases where there are two in there.

Q. Now, what period of time did you use to set up this gathering system? A. You mean this coming up with this $4½ million?

Q. Yes. A. The estimates were as of estimated '58 tie-ins, from beginning through 1958, estimated.

Q. I see.

And how many Pacific wells did you consider in this estimate? A. 155.

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Q. Now, you have given Pacific's savings as the result of this. You also mentioned something about the benefits to El Paso. Have you figured up the dollar benefits to El Paso from all of this arrangement? A. They were estimated as between a quarter of a million or half a million dollars.

Q. In other words, it was advantageous to both companies. A. Yes, sir.

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M. C. Norwood

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resumed the stand and, having been previously duly sworn, was examined and testified as follows:

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Cross-Examination

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Q. Now, Mr. Norwood, at my request I believe you prepared a further exhibit or schedule, I should say, reflecting the operating revenues, expenses and income of the El Paso Natural Gas Company and the four subsidiary companies that you have referred to in your direct, and also as to the Pacific Northwest Pipeline Corporation, and you have shown those schedules for the year 1957 through the year 1964, have you not? A. Yes sir, I have.

2344

Q. Do you have additional copies of this schedule? A. Yes, we have, Mr. Kurtz.

Mr. Kurtz: Mr. Examiner, I now request that there be given the next exhibit number to a document entitled on its face "Additional Information Requested Informally by FPC Staff on October 10, 1958, in Docket No. G-13019."

This consists of an exhibit comprised of six tabs.

Presiding Examiner: Let that be identified as Exhibit No. 383.

(The Document Referred to was Marked for Identification as Exhibit No. 383.)

By Mr. Kurtz:

Q. Mr. Norwood, referring to Exhibit 383, Tab 1, am I correct in my understanding of this exhibit that you have

shown through the years 1957 to and including 1964 the El Paso Natural Gas Company and its four subsidiaries, the Pacific Northwest Pipeline Corporation, under separate columns, the consolidating adjustments that would occur and the companies after the consolidation or merger? Is that right? A. Yes, sir, that is right.

Q. In other words, under the heading "Consolidated", that is your judgment as to what the operating revenues and expenses will be as though a merger had occurred; is that right? A. That is right, for the years 1959 and subsequent.

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Q. And subsequent. A. For the years 1957 and 1958, the information as reflected on this schedule assumes the consolidated operating results with Pacific Northwest Pipeline Corporation being operated as a subsidiary company.

Q. All right. Let us take the year 1959 as you have shown it here under the heading "Pacific Northwest Operating Division." If it was a separate corporation, would the same operating revenues and expenses be incurred as you have shown it here? A. Yes, that is true, Mr. Kurtz. They would be the same. However, when we come down to the question of Federal income taxes and the net after Federal income taxes, there would be a difference, and if I may, I would like to explain why.

Q. All right, I wish you would. A. If the companies operate on their present basis, that is, Pacific being a subsidiary of El Paso—

Q. Now, we are talking about the year 1959, as an example? A. Yes.

Q. All right. A. In the filing of the returns, in the consolidated returns that would be filed, if they operated as a subsidiary, then only to the extent that Pacific showed earnings, taxable

earnings, for that year could the pre-1957 tax loss carry-forwards of Pacific be utilized, but on a consolidated—on a merged basis, rather, those loss carry-forwards could be utilized to the extent that the surviving corporation had taxable income.

Q. Oh, I see. On that item, then, for the year 1959, if I understand this schedule correctly, you have taken advantage of the loss carryover of Pacific Northwest. A. Yes, to the extent that it could be utilized in that year, Mr. Kurtz.

Presiding Examiner: May I interrupt? Do you have the Treasury regulations authorizing those things to which you could refer us conveniently? There might be some dispute about it later, and it might be nice to have them in the record.

The Witness: Well, the Tax Code section would be 381.

Presiding Examiner: All right, sir, that is fine, just so we have something in the record that shows the authority of the corporation to handle the tax matter that way.

By Mr. Kurtz:

Q. If I understand this schedule correctly, then, if Pacific is operated as a separate corporation, in the year 1959 it would pay no Federal income tax; is that right? A. Yes, sir, that is right.

Q. And it would pay no income tax in the year 1960; is that right? A. That is correct.

Q. And how about 1961, as to Pacific Northwest, if it was a separate corporation? A. Well, Mr. Kurtz, you referred to it as being a separate corporation.

Q. Yes. A. This schedule was prepared on the basis of it being a merged corporation.

Q. Well, now, let us get back to my question. I was not quite aware of the basis on which this was set up, but let us get back in the year 1961.

Now, you show provisions for Federal income tax and you show for the El Paso Natural Gas Company and four subsidiary companies the first item on line 36 as $19 million plus? A. Yes, that is right.

Q. And you show none for Pacific. And on line 37 you show $11 million plus for El Paso and $84,000 plus for Pacific Northwest. Does that mean that Pacific Northwest would be obligated to pay $84,000? A. Yes. It would be—for purposes of this statement we have attempted to allocate to Pacific's operations that portion of the total tax that would be paid by the merged

corporation.

Q. All right. Well, at that point, in 1961, you would have used up all of the tax carryover of Pacific Northwest here referred to as the $23 million in this proceeding, is that not correct? A. Yes, that is right.

We would have used it up before then, Mr. Kurtz. The pre-1957 losses.

Q. Well, when would that occur? A. In 1959 and 1960.

Q. In other words, under this column, 1961, where you have assigned these Federal income taxes, if Pacific did not have any—if it was operated as a separate corporation and had no tax loss carryover, that is what you figure would normally be its Federal income tax? Is that the way it works? A. Yes, I think that is correct.

Q. And the same thing would be true for the subsequent years here shown? A. Yes.

Q. Now, looking at page 1, I should call it sheet 1, under the year 1957, see if I understand this schedule correctly. On line 44 it says, "Net income (loss) after provision for preferred dividends," and in the year 1957 this

shows a net loss of $900,119. Am I reading that correctly? A. Yes, sir, that is right. That is for Pacific.

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Q. Yes, for Pacific. A. Yes.

Q. Pardon me.

And on the same line, in the year 1958 you show a net income in the black of $1,911,885. Am I reading that correctly? A. For Pacific Northwest, yes.

Q. Yes.

Let us take the year 1959, for example. Well, let us go to 1958 and let us look at the consolidated adjustments on line 4. Under the heading "Sales Other Than to California Companies," now, that consolidated adjustment figure is $8,433,531. That represents the inter-company sales between Pacific and El Paso? A. Yes, it does.

Q. And is made up of both sales by El Paso to Pacific and by Pacific to El Paso? A. Yes, sir.

Q. Well, could you give me the amount there that is related to El Paso's sales to Pacific and likewise the Pacific sales to El Paso? A. Yes.

Q. All right. Would you break that out? A. El Paso Natural Gas Company sales to Pacific under its Rate Schedule X-6 is $487,531.

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Q. What was that? A. $487,531.

Q. Thank you. A. And Pacific's sales to El Paso under Pacific's Rate Schedule X-1, $7,946,000.

Q. And I note for the year 1959 that there is the figure of $8,775,107. Could you give me the like figures? A. Yes. El Paso's sales to Pacific Northwest under Rate Schedule X-6, $559,107, and Pacific's sales to El Paso, $8,216,000.

Q. And for the year 1960? A. El Paso's sales to Pacific Northwest, $335,464. Pacific's sales to El Paso under Rate Schedule X-1, $8,216,000. And of the sales that Pacific

would make to El Paso under the—there is no rate schedule to it yet, but that is the Provo line.

Q. Provo-Las Vegas line, as the Examiner said he named it. A. Yes, sir, the Provo-Las Vegas line, $11,938,758.

Q. And for the year 1961? A. El Paso's sales to Pacific under Rate Schedule X-6, $237,965. Pacific's sales to El Paso under Rate Schedule X-1, $8,216,000. And the Provo to Las Vegas sales, $12,137,843, for a total of $20,591,808.

Q. And for the year 1962? A. No sale by El Paso to Pacific. Pacific's sales to El Paso under Rate Schedule X-1, $8,216,000. The Provo to Las Vegas sales, $24,714,215, for a total of $32,930,215.

Q. Now, wait just a minute. We are talking about the year 1962. I wish you would look at that schedule. Isn't that a misprint? A. $32,900—

Q. Wait just a minute. Oh, I am looking at the wrong column. I beg your pardon. It is my error.

All right. For the year 1963? A. Pacific's sales to El Paso under Rate Schedule X-1, $8,216,000. The Provo to Las Vegas sale, $25,546,454, for a total of $33,762,454.

Q. And for the year 1964. A. Pacific's sales to El Paso, Rate Schedule X-1, $8,216,000. Pacific's proposed sale to El Paso, Provo to Las Vegas line, $25,960,666.

Q. Now, going back to the year 1958 on this schedule, the next consolidating adjustment is Extracted Products Sales. Now, that dollar amount relates to the sales by Pacific to El Paso, does it not? A. Yes, it does.

Q. And what is this item "Other Operating Revenues"? What does that consist of, in general?

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A. Well, that is in general from the sale of drip gasoline, incidental oil sales, rentals from company-owned cottages, and so on.

Q. That would be from Pacific to El Paso, would it not? A. $150,000 of that item that you see in the total of $162,000 represents El Paso Natural Gas Company's transportation revenues for Pacific Northwest Pipeline Corporation, and $12,000 is the transportation revenues from El Paso Natural Gas Company to Pacific.

Q. Well, that would be in the San Juan? A. Yes, sir. That is correct.

Q. Now, your next consolidated adjustment is under "Expenses, Cost of Gas." And that item there—that is the same item as we were talking about under Line 4, Public Utilities for Resale, is it not? A. Yes. It is the contra adjustment, Mr. Kurtz.

Q. I see.

Now, the next item that you have is "Field Handling Expenses—Operation and Maintenance," on Line 20. A. That was the same as the item that we had previously discussed on the contra side, that is, the expense side, and it relates to the Extracted Products Sales.

Q. And the $162,000 item is comparable to the Other Expenses we just discussed. A. The Other Revenues we just discussed.

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Q. Yes. The Other Revenues.

If I understand this correctly, you show on Line 49 the rate of return, for instance, under the year 1957 for El Paso of 7.46 per cent, upon the rate base that you have shown here. A. Yes, sir.

Q. And for Pacific you show a return of 3.17 per cent. A. Yes, sir.

Q. And consolidated it would be 6.41 per cent. A. Yes, sir.

Q. That is the way that these are carried through. A. Yes, sir.

Q. Now, in the year 1959 you show a rate of return for El Paso of 7.76 per cent and for Pacific Northwest operating division of 3.38 per cent. Now, if I understood what you said a minute ago, that 3.38 per cent for the year 1959 would be the rate of return earned by Pacific Northwest if it was a separate corporation. I am thinking of the tax item, Mr. Norwood. A. The statement was not prepared on the basis that it was a separate corporation, but in computing the Federal income taxes that El Paso would—the merged corporation would get the benefit of any—

Q. Well, yes, but as I understood your statement here, for the year 1959 and other years, but let us take the year 1959, as I understood your statement if Pacific was operated as though it were a separate corporation, there would be no change in that

year, but the only change comes about in these schedules for the various years as a result of the Federal income tax. A. Yes. You are right, Mr. Kurtz, since no tax is shown.

Q. If they paid no taxes, then as a separate corporation under your study they would be earning 3.38 per cent. A. Yes.

Q. And that same thing would hold true, the return you show for the year 1960. A. Yes sir.

Q. But in 1961, if I understand correctly, the return of 4.05 per cent shown there, if Pacific had been operating as a separate corporation, that return would have been higher only by reason of Line 37 which is the provision for the

Federal income tax. Is that right? A. Well, I am not quite sure that I understand that, Mr. Kurtz.

Q. All right. What I am getting at is we have no changes in any of the various revenue and expense items except the provision for Federal income tax, and I note that you have a provision for deferred Federal income tax of $84,394.

Now, if Pacific had been a separate corporation, it would not have paid a tax in this year, would it? A. It probably would not have, Mr. Kurtz.

Q. Well, on the basis that it would not have, then that, of course, would affect the rate of return.

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A. Yes.

Q. And it would be a higher rate, whatever that might be. A. Yes, that is right.

Q. Well, how about the year 1962? You show provisions for Federal income tax—you have a considerable item under Pacific. Would that same set of facts occur in that year as for 1961, if you know? A. No, I do not know. It would require the making of a tax computation.

Q. And for the subsequent years you have shown here, 1963 and 1964, it would require that tax computation. A. Yes, that is right.

Q. Otherwise, if we made that tax computation, then we could determine what El Paso's income would be and what Pacific's income would be as separate corporations. A. Yes, sir.

Q. Now, turning to Sheet 3 of Exhibit 383, would you tell us what this shows? A. It shows a consolidated pro forma balance sheet as of December 31, 1957, as of December 31, 1958, and as of January 1, 1959, for El Paso Natural Gas Company and four subsidiary companies, Pacific Northwest Pipeline Corporation, the consolidating adjustments and the consolidated totals.

Q. And the only change as shown here is that if the rates

applied for in Docket No. G-12948 were not in effect, as you had assumed for your Sheets 1 and 2. Is that right? A. Well, Sheets 1 and 2 are—that is—

Q. In other words, let me ask it this way, Mr. Norwood.

Mr. Payne: May I ask a question, Mr. Kurtz? Are you talking about Sheet 3 under Tab 1 or Tab 3?

Mr. Kurtz: Sheet 3 of 5.

The Witness: I am sorry, Mr. Kurtz. I understood you to say Tab 3.

By Mr. Kurtz:

Q. Did I? I'm sorry. A. I probably misunderstood you and that was my difficulty in answering your question. Sheet 3 under Tab 1 shows the amount by which gross revenues would have been reduced on the income statement shown under Tab 1 had the increased rates in Docket No. G-12948 not been given effect to.

Q. Turning to Sheet 4 of 5 of Tab 1, you show your computation of the rate base of El Paso and Pacific and combined which is reflected upon Sheet 1. Is that not correct? A. Yes, for the years that are shown, for each of the years that are shown on that schedule.

Q. Sheet 1, insofar as the working capital is concerned, represents a further breakdown in the item that you show on Sheet 4. Is that correct for the years 1959 through 1964?

A. Yes.

Q. And so that we can shorten this, as I understand it, Mr. Norwood, you have included along with the schedules requested your computation of Federal income tax for the calendar years 1958 through 1964 as shown on Tab 2. A. Yes.

Q. The balance of the information in Exhibit 383 I believe is necessary for the determination of the rate of return that you show on Sheets 1 and 2. Is that the way it works? A. Yes, that is right. And it also includes information, Mr. Kurtz, of a kind that was requested in connection with the original application that was submitted, the journal entries and things of that nature showing the effect of the consolidation.

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Q. Now, on your Exhibit 383, Sheet 1 of 5, under Tab 1, for example in the year 1959, Line 13, you show an item of $17,941,004, and that item is labeled, "Provision for Increased Revenues That Will Result From Increased Gas Costs Included Herein."

Now, is that the amount of these various increase that we have been talking about? A. Yes, it is, for that year.

Q. In other words, what you did was to take for the year 1957 and 1958 the operating revenues from your sales as based upon your—no, wait a minute. Strike that.

Is this the way it works? Under your sales revenue, you

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carried forward the tariff filings, but this particular item on Line 13 reflects what you think the additional revenues will have to be to offset these additional costs? A. Yes, that is right. Actually, what happened, Mr. Kurtz, in computing the expenses for the year 1959 and subsequent years, we made provision for the increased rates that have been filed by the producers, or those that we expect to be filed, to a level to bring them up to a level of the ones that were filed by Phillips that I have just referred to. The resulting calculations showed that our costs would be increase by those amounts.

Now, since, in those parts, the company is paying those costs, or they have been accepted by the Commission and deferred for a later period for collection, I felt that it was only proper to reflect a provision for the costs, payment of those costs, and a like provision for the revenues to be increased to take care of them.

Q. Yes. What I had in mind, though, was the sales revenues that you show on Lines 1 through 12—those above Line 13 I have reference to. All revenues that you show for the years through 1964 are based upon your present tariff or contract rates? A. Yes, that is right.

Q. On this same Exhibit 383, under Expenses, Line 18, "Cost of Gas," do the cost figures therein reflect payments for

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gas that has been taken? A. No, they do not.

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By Mr. Bennett:

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Q. Now, to make this clear, Mr. Norwood, if you would refer to Exhibit 383, Tab 2, Sheet 2 of 7, you will note therein on Line 22 this item:

"Pacific's pre-1957 loss carryover on straight line depreciation basis ($22,855,243)."

Do you find that?

Mr. Grambling: What line was that, Mr. Bennett?

Mr. Bennett: Line 22.

By Mr. Bennett:

Q. Do you see that, Mr. Norwood? A. Yes, I see that.

Q. Now, is it your opinion that that loss carry-forward should be used to reduce the cost of service to the cus-

tomers of the Pacific Northwest Pipeline system? A. No, it should not be used for that.

Q. And what is the reason for that conclusion? A. The mere fact that it results in a—that this credit carry-forward results as a loss, to me, is sufficient reason that it should not be used at some future year, in some future year, to reduce rates to the customers who were not served at that time.

Now, in further explanation of that, Mr. Bennett, let me tell you that in so far as Pacific is concerned, and Pacific standing alone, or even Pacific as a subsidiary of El Paso, Pacific would not be able to utilize that tax credit.

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By Mr. Bennett:

Q. Now, directing your attention to the items of anticipated revenue set forth in Exhibit No. 383, on Line 23, which is before you—Line 13, pardon me—does the amount of $17,941,004 in 1959 represent the proposed rate increase which Mr. LaForce was testiying about in his testimony here yesterday? A. No, Mr. Bennett. This represents, as I told Mr. Kurtz, an offset to the amount of increased gas costs that we showed under the expense caption of this schedule.

Q. Well, do you expect to ask for an increase to offset

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those increased costs? A. Well, I would think that the company would ask for that, Mr. Bennett.

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By Mr. Kurtz:

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Now, Mr. Norwood, at the present time how near completed are your studies relating to the next rate filing that was referred to by Mr. La Force? A. They are near enough completed, Mr. Kurtz, to where I can tell you that it is contemplated that we will be making a filing in the very near future.

Q. When you say very near future, timewise, Mr. Norwood, when do you contemplate it? A. Well, I would hope that it would be within the next 30 days, Mr. Kurtz.

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L. G. Truby

resumed the stand and testified further as follows:

Presiding Examiner: Resume any time with your cross-examination of Mr. Truby, Mr. Kurtz.

Mr. Kurtz: All right, thank you.

Cross Examination

By Mr. Kurtz:

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Q. In other words, at this time if it were not for these obligations of Pacific to drill the number of wells that you have given in the San Juan Field, it would be possible for

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Pacific to meet its requirements from other connected sources. Is that right? A. Very possible, yes, sir.

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Ralph F. Gates

was called as a witness and, after being first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Kurtz:

Q. Mr. Gates, will you sate your name for the record, please? A. Ralph F. Gates.

Q. And you are employed by the Federal Power Commission? A. Yes, sir.

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Q. Mr. Gates, are you familiar with the stipulation

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in this case, being Exhibit No. 380 dated September 9, 1958, specifically paragraph 1, which relates to $4,702,856.37 which is said to "represent profits between companies under common control" which arose

(3)

out of various agreements and contracts between companies under common control? A. I am familiar with the accounting questions which arose concerning the matter of profit to companies under common control with Pacific Northwest which gave rise to this stipulation.

Q. What does the amount of $4,702,856.37 represent? A. The amount represents profits derived during the period 1950 through 1957 to Fish Engineering Corporation, Fish Service Corporation (formerly Fish Service and Management Corporation), and Fish Northwest Contractors, Inc., from contracts entered into with Pacific Northwest Pipeline Corporation. The stipulation acknowledges that these several Fish companies were under common control with Pacific Northwest Pipeline Corporation.

Q. Has the Office of the Chief Accountant examined the books and records of the Fish companies to ascertain and verify the amount of $4,702,856.37 of profits to the Fish companies arising from the contracts entered into with Pacific Northwest? A. No, the Office of the Chief Accountant has not done

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any audit work with respect to the records either of the

Fish companies or Pacific Northwest Pipeline Corporation. The figure of $4,702,856.37 was furnished by letter dated July 1, 1958, from El Paso Natural Gas Company, in response to a letter from the Commission requesting a tabulation of the profits to the Fish companies included in the plant accounts of Pacific Northwest from the period of inception through December 31, 1957.

(4)

Q. Had the Office of Chief Accountant made an audit, or if such an audit is made, it is possible, is it not, that the Fish profits may be greater than the figure of $4,702,856.37? A. That is true.

Q. What kinds of services were performed by the Fish companies? A. We have not ascertained this as a matter of fact from an examination of the records of the Fish companies of the Pacific Northwest Pipeline Corporation; however, material available indicates the contracts, in general, covered services in the design and construction of Pacific's pipe line system, engineering and design services with respect to compressor stations, meter stations, gasoline and dehydration plants, preparation of construction drawings, purchasing and expediting materials, other engineering services; management and consulting services of various kinds. Brief descriptions of these services

and the basis of charges are shown on Schedule 5 of the First Supplemnt to Original Application, Docket G-13019 filed by El Paso Natural Gas Company, December 23, 1957. This material shows that the service contracts with Fish Northwest Construction Inc., Fish Engineering Corporation and Fish Service and

(5)

Management Corporation were dated in 1954. The first page of this material shows that charges of these com-

panies for fees and services to Pacific Northwest from inception to May 31, 1957, were $7,600,633.68. So far as I have been able to ascertain, the services by Fish organizations prior to the 1954 service contract dates were covered by proposal of The Fish Engineering Corporation, dated August 9, 1950, and accepted by Pacific Northwest August 11, 1950. This letter agreement was filed as Exhibit M in Pacific Northwest's third amended application in Docket G-1429.

Q. You state that the total charges for fees and services to May 31, 1957, were $7,600,633.68. Why does this differ from the amount of $4,702,856.37 referred to in the stipulation? A. The $7,600,000 figure is the gross charges for fees and services to May 31, 1957, reported for information of the Commission's staff. The $4,700,000 figure, on the other hand, is the calculated profit from fees and services to December 31,

1957, as reported by El Paso for information of the Commission's staff by a letter from El Paso, dated July 1, 1958.

Presiding Examiner: May I interrupt a minute? The witness used the word "profit," but I am a little at sea as to whom the profit went to. Whose profit?

Mr. Kurtz: Fish Engineering Corporation.

Presiding Examiner: In other words, the $4,000,000 is a calculation of profit to him as distinguished from some gross in the $7,000,000? I don't understand.

Mr. Kurtz: Do you want to ask the witness?

The Witness: It is a calculated profit to these other Fish companies.

Presiding Examiner: Net profit? Is that what you are discussing?

The Witness: It is the profit less the cost of services. The gross billing less the costs assigned to it.

Presiding Examiner: Fine. I understand it now. Then it is something of a net profit to the Fish organizations.

The Witness: That is true.

Presiding Examiner: Now, that I may not be all at sea, the $7,000,000 does include the $4,000,000 in the calculation. That is true, Mr. Gates?

The Witness: It does, except that the $4,700,000 is the net profit carried on out to December 31, 1957, whereas the $7,000,000 figure goes only to May 31.

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Presiding Examiner: All right. Thank you, sir. Excuse the interruption. Proceed, gentlemen.

By Mr. Kurtz:

Q. Do these profits fall within the Commission's "no-profits-to-affiliates" rule? A. They do.

Q. And what is the "no-profits-to-affiliates" rule? A. The rule is one whereby transactions between affiliated interests are not deemed to be transactions at arms-length and hence the cost basis of such transactions excludes any element of profit to the affiliated interests.

(6)

The rule reflects a long-standing policy of the Commission which has been substantiated by a long list of decisions, including the California Oregon Power Company case. I interpret the stipulation in this case as indicating the $4,702,858.37 to be a profit to affiliates and its inclusion in the plant accounts of Pacific Northwest as falling within the "no-profits-to-affiliates" rule.

Q. In addition to the stipulation, what information has come to your attention which indicates there was affiliation

or common control of the Fish companies and Pacific Northwest? A. In view of the stipulation we have not deemed it necessary to make as thorough a review of this question as might have been necessary otherwise. We have, however, examined

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various materials and testimony in this case. These I believe indicate clearly that Mr. Fish and his associates were in control of the companies which bear Mr. Fish's name. The data also indicate that the management and direction of Pacific Northwest was effectively in the control of Mr. Fish and his associates of the Fish companies at the time of entering into the engineering, service and construction agreements with the Fish Companies, and subsequently. The situation was not one in which real arms-length bargaining could have prevailed.

(7)

Q. What disposition do you propose for the so-called Fish profits included in the plant accounts of the Pacific Northwest properties? A. It is my recommendation that if the Commission approves the merger application in this case the amount of $4,702,856.37 be removed from the Pacific Northwest plant accounts and charged to the $10,000,000 reserve for adjustments of plant and depreciation reserve accounts to be created by El Paso, referred to in paragraph 2 of the stipulation of September 9, 1958, as well as any additional amounts of a similar nature which may later be disclosed from audit and examination of the accounts of the Pacific Northwest properties and the accounts of the Fish companies. The said reserve of $10,000,000 in turn should be created either prior to the merger or incidental thereto from the surplus account of the merged companies. Regardless of

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whether the merger is consummated the profits of the Fish contracts should be removed from the accounts of Pacific Northwest and charged to surplus of Pacific Northwest.

Q. The stipulaton, in paragraph (2), refers to a total reserve of $10,000,000 which El Paso consents to set up in its books and records and to reflect in its financial statements, to be available for adjustment of the plant

(8)

and depreciation reserve accounts of Pacific Northwest Pipeline Corporation. To what does this amount, which is in excess of the $4,700,000 for profits to the Fish companies from fees and services, relate? A. The total reserve of $10,000,000 includes provision for approximately $5,300,000 of other adjustments in addition to the $4,700,000 for profits on fees and services. Provision for other adjustments in a minimum amount of $5,300,000 is indicated to be necessary from a examination of financial information available to the staff in this case. Specifically, the available data indicated to the staff that there is included in Pacific's plant accounts certain improper amounts classified in Account 302, Franchises and Consents, and that there is an excessive charge for interest during construction. The data also indicated an insufficiency in depreciation provisions. The Office of the Chief Accountant, of course, has not had an opportunity to examine the underlying details of

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these amounts and desires an opportunity to examine such details and to give the amounts further consideration before formulating specific adjustments to the plant accounts and depreciation reserve. An audit of the accounts of Pacific Northwest may indicate some change in the amounts of adjustments to which the $10,000,000

reserve relates and disclosure of other adjustments. For present purposes $5,300,000 of the $10,000,000 reserve may be considered as a general provision for probable adjustments over and above the $4,700,000 relating to profit on fees and services charges.

Q. Thank you, Mr. Gates.

Mr. Kurtz: I have no further questions.

Presiding Examiner: Cross-examine, Mr. Payne or Mr. Shannon?

Mr. Payne: No cross-examination.

Presiding Examiner: Does anyone else have cross-examination of Mr. Gates? Hearing no response, Mr. Gates, you are excused without cross-examination, sir.

(Witness excused.)

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2752

Robert T. Simonds

was called as a witness and, after being first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Kurtz:

Q. Please state your name for the record. A. My name is Robert T. Simonds. I reside at 7305 Cedar Avenue, Takoma Park, Maryland.

Q. And you are employed by the Federal Power Commission? A. Yes, sir, I am.

Q. In what capacity? A. I am a Public Utilities Specialist in the Bureau of

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Rates and Gas Certificates.

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Presiding Examiner: Let that be identified as Exhibit No. 420.

(The Document above referred to was marked for identification as Exhibit No. 420.)

By Mr. Kurtz:

Q. Mr. Simonds, did you prepare Exhibit 420, consisting of two pages, the first of which is entitled, "El Paso Natural Gas Company, Docket No. G-13019, Apportionment of Costs to Zones—Year 1960 (Assuming Merger)"? A. I did.

Q. What does this exhibit reflect? A. This exhibit reflects a different distribution of costs to areas or zones than is set forth in Exhibit 382 by El Paso Company.

Q. What is the source of the data you have used on sheet 1 of this exhibit? A. This data is taken from Exhibit 382, section C, schedule 1, except for, first, the percentage responsibilities for peak demands and annual sales; secondly, staff calculated costs, and thirdly, revenue deficiencies.

Q. How were the staff calculated costs computed? A. The costs were computed by applying the percentage responsibilities shown on page 1 to the assigned demand and commodity costs shown on page 2 of this exhibit.

Q. Turning to page 2 of this exhibit, will you please

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explain the derivation of the figures shown there? A. The notes on this page show that the basic figures are taken from Exhibit 382, prepared by El Paso. I have made an assignment of El Paso costs to the demand and commodity components following the principles enunciated in Opinion No. 225, the so-called Seaboard case, but using an

abbreviated method which is practical for El Paso in this instance and for the purpose at hand.

Q. Explain briefly the method you have followed on this page 2. A. I have assigned the cost of gas purchased from pipelines to the demand and commodity cost component in keeping with the demand and commodity charges of the rate schedules under which the gas would be purchased. All other production costs have been assigned to the commodity component. All other costs have been divided between the two cost components, 45 per cent to demand and 55 per cent to commodity.

Q. Have you tested this abbreviated method in connection with El Paso costs and allocations in other proceedings? A. Yes. I tested this method against the detailed cost computations in Opinion No. 278 and those in the Examiner's decision in Docket No. G-4769 and found it to be accurate within 1 per cent.

Q. By this exhibit, in which you rely entirely upon figures introduced by El Paso, are you sponsoring any costs,

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rates of return, tax computations, or other cost items of El Paso? A. I am not. I have used El Paso figures so that there would be a direct comparison of results between the method of cost apportionment followed by El Paso and that used by the staff.

Q. What does the staff exhibit show by comparison with El Paso Exhibit 382? A. On page 1 it shows that using the Seaboard method of apportionment, that is, the peak responsibility method for apportioning demand costs and annual sales for the apportionment of commodity costs, the costs after the merger, generally speaking, would be higher for the old El Paso customers and lower for the Pacific Northwest customers and lower for the sales to be made from the Provo—Las Vegas line; that is, they would

be lower than would result from the apportionment method used by El Paso.

Mr. Kurtz: At this time, Mr. Examiner, I would like to have marked for identification an exhibit entitled, "El Paso Natural Gas Company, Docket No. G-13019, Apportionment of Costs to Zones — Year 1962 (Assuming Merger)," consisting of two pages.

Presiding Examiner: That is identified as Exhibit No. 421.

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John F. Roberts

was called as a witness and, after being first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Furbush:

Q. Will you please state your name and address, sir? A. My name is John F. Roberts. My address is 245 Market Street, San Francisco.

Q. Who is your employer? A. Pacific Gas and Electric Company.

Q. What is your position with that company? A. I am the assistant manager of the Rate Department.

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Q. Do you have the exhibit marked for identification as No. 423 before you, Mr. Roberts? A. Yes, I have.

Q. Was this prepared under your supervision? A. It was.

Q. Will you please refer to this exhibit and explain its purpose? A. The purpose of this exhibit is to bring out clearly the costs which the allocation procedures used by

El Paso in its exhibits would assign to P G & E, and, also, what the assignments would be under a system-wide basis of allocation for the years 1960 and 1962. Basic data are from exhibits introduced by El Paso, showing costs both before and after the proposed merger, so that the increases in such assignments as a result of the merger are indicated.

Q. What allocation procedures has El Paso followed in its exhibits? A. El Paso has followed a system-wide basis for allocation of its production costs and a zone basis for allocation of its transmission and storage costs.

Q. When you refer to production costs, what do you include? A. All of the costs of purchased gas, and the cost that

El Paso experiences in producing its own wells.

Q. But it does include purchased gas? A. Yes, it does.

Q. Did El Paso use a system-wide basis for allocating transmission costs? A. No, it did not.

Q. Why, then, did you use a system-wide basis for allocating transmission costs as a basis for Exhibit 423? A. Because this is in one of the bases used by the Commission staff in its allocation of El Paso costs in the rate cases in which I have participated, Dockets G-2018 and G-4769, before this Commission, and because it was followed by the Examiner—by the Commission in its opinion in Dockets No. G-2018, and by Examiner Simpson in his decision in Docket No. G-4769.

Q. Does your use of El Paso exhibits, wherein they have developed costs by zones, both before and after the proposed merger, mean that you agree that the amounts shown are appropriate to be assigned to various zones, particularly to Zone 5, and to P G & E, which is included in Zone 5? A. No, but I want to set forth the amounts of increase in costs shown from El Paso's exhibits, which

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their figures and method would allocate to P G & E as a result of the proposed merger, and the further impact of costs if the system-wide method of allocation were applied to the costs developed by

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El Paso.

Q. Will you please explain the exhibit at this time? A. The summary of the findings in the exhibit are shown on the first page, schedule 1, sheet 1 of 1.

Q. For the year 1960, I used the data shown in Exhibit 382, and developed the costs for P G & E as $124,174,478, paralleling the methods that they had used. For the allocation after the merger, their cost allocated to P G & E is $126,082,063, an increase of $1,907,576 to P G & E as a result of the merger.

For 1962, the zone-allocation method before the merger, as shown on the first line under 1962, is $115,803,770. After the merger, using the zone-allocation method, the cost to P G & E is $117,659,143, an increase of $1,855,373.

I further applied a system-wide allocation to the cost after the merger, in which the unit-demand and commodity costs are spread equally among all customers. I found that in 1960, such an allocation would produce a cost to P G & E of $131,380,993, or a further increase over the zone method, after the merger, of $5,298,930. This is all for the year 1960. So that, if we went from before the merger to after the merger with a system-wide method of allocation, we would have a total increase in costs of $7,206,506.

Q. Mr. Roberts, that is an increase from the cost of service on the basis of the zone allocation before, and then

to a system-wide allocation after? A. That is correct.

Now, for 1962, applying a system-wide allocation method after the merger, the cost to P G & E would be $120,323,813, or a further increase of $2,664,670. The total increased cost to P G & E in 1962 would be the sum of the increase on the zone method after the merger, plus a system-wide further increase, or a total of $4,520,043.

The remainder of the exhibit backs up the figures taken directly from El Paso's Exhibit 382, for the figures on the year 1960, and from Exhibit 382 for the year 1962, and from Exhibit P in Application 16235, for the year 1962, prior to the merger.

I think the exhibit is fairly self-explanatory.

Q. Mr. Roberts, did you say that for the year 1962, you used El Paso's Exhibit 382, or did you mean Exhibit 28? A. Pardon me, I used Exhibit 28 for the year 1962.

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Homer R. Ross

was called as a witness and, after being first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Lippitt:

Q. Mr. Ross, will you please state your full name and address. A. Homer R. Ross, 810 South Flower Street, Los Angeles, California.

Q. By whom are you employed? A. Southern Counties Gas Company of California, as rate engineer.

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Q. Well, now, then, taking your testimony as a whole, would you summarize the objectives and recommendations which you make in your testimony. A. The principal purpose of my testimony is to point out the cost allocation problems that may arise on a merged El Paso—Pacific Northwest System if the merger is approved. In order to meet these problems, when the occasion arises in the future, certain definite cost information is required on a segregated basis.

My purpose is to call attention to the type of such cost information which would be required. A subsidiary purpose of my testimony is to call attention to some of the shortcomings of the so-called system-wide cost allocation on Pacific Northwest's System as presented by El Paso and that the studies

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presented by El Paso in this proceeding are not necessarily the final answer to the problem.

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